

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

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United States Court of Appeals for the District of Columbia

APRIL TERM, 1935

No. 6458

708

GUANTANAMO SUGAR COMPANY, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTER-
NAL REVENUE.

ON PETITION TO REVIEW THE DECISION OF THE UNITED STATES
BOARD OF TAX APPEALS.

FILED APRIL 11, 1935.

PRINTED MAY 20, 1935.

United States Court of Appeals for the District of Columbia

APRIL TERM, 1935

No. 6458

GUANTANAMO SUGAR COMPANY, PETITIONER,

versus

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

ON PETITION TO REVIEW THE DECISION OF THE UNITED STATES
BOARD OF TAX APPEALS.

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., APRIL 25, 1935.

United States Court of Appeals for the District of Columbia

No. 6458.

GUANTANAMO SUGAR COMPANY, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue.

1

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Appearances:

For Taxpayer: Alfred C. Frodel, Esq. (withdrawn)
David A. Buckley Jr., (withdrawn) Lawrence P. Mattingly,
Esq. (withdrawn) Frank E. Scott, Esq., (withdrawn)
Richard S. Holmes, Esq.

For Comm'r.: W. Frank Gibbs, Esq., Bruce A. Low, Esq.

Docket Entries.

1929.

Mar. 16. Petition received and filed. Taxpayer notified.
(Fee paid.)

Mar. 18. Copy of petition served on General Counsel.

May 3. Answer filed by General Counsel.

May 6. Copy of answer served on taxpayer. General
Calendar.

1931.

Jun. 24. Notice of appearance of David A. Buckley, Jr., as
counsel filed.

Oct. 28. Hearing set Dec. 15, 1931.

Dec. 14. Motion to place on the New York City Circuit
Calendar filed by taxpayer, 12/15/31 granted.

1932.

- Jan. 2. Notice of the withdrawal of Alfred C. Frodel as counsel for taxpayer filed.
- Jan. 18. Notice of the appearance of L. P. Mattingly as counsel for taxpayer filed.
- Jan. 26. Motion for leave to file amended petition filed by taxpayer. Amended petition tendered.
- Jan. 28. Motion for leave to file amended petition granted.
- Feb. 1. Copy of motion and amended petition served on General Counsel.
- Feb. 10. Answer to amended petition filed by General Counsel. 2/17/32 copy served.
- Aug. 11. Hearing set in New York beginning Sept. 12, 1932.
- Sep. 26. Hearing had before Mr. Murdock on motion to continue—held C. A. V.
- Oct. 4. Order denying motion for continuance and granting respondent's motion for dismissal for failure properly to prosecute entered, John E. Murdock, Div. 3.
- Oct. 22. Motion to vacate order of dismissal filed by taxpayer.
- Oct. 24. Motion to vacate order of dismissal denied.
- Nov. 3. Hearing set Dec. 5, 1932.
- Nov. 4. Notice to disregard hearing notice of Nov. 3, 1932.
- Dec. 13. Motion to vacate order of dismissal lodged by taxpayer.
- Dec. 16. Motion to vacate order of dismissal filed by taxpayer. 12/20/32 denied.
- Dec. 16. Notice of appearance of Frank E. Scott as attorney for taxpayer filed.

1933.

- Jan. 4. Notice of withdrawal of David A. Buckley as attorney for taxpayer filed.
- Jan. 4. Notice of withdrawal of Lawrence Mattingly as attorney for taxpayer filed.

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- Jan. 4. Motion to reconsider order of dismissal and place on Calendar.
- Jan. 4. Order vacating order of dismissal and placing proceeding on New York City Circuit Calendar for hearing last week in Feb. 1933, entered.
- Feb. 23. Motion for next hearing in New York filed by taxpayer. 2/25/33 granted.

1933.

Mar. 3. Hearing set in New York, beginning April 17, 1933.

Apr. 20. Hearing had before Miss Matthews on merits. Case partially submitted and continued to May 1 for further hearing on the merits. (No order for this is necessary) Notice of withdrawal of Mr. Scott and appearance of Richard S. Holmes Esq., Briefs, no date set.

May 1. Hearing had before Miss Matthews on motion to continue this case partially heard on April 20, 1933 and held over for further testimony. Continued to May 9, 1933 for further hearing on the merits in Washington.

May 1. Order of continuance to May 9, 1933 in Washington, D. C. entered.

May 5. Transcript of hearing of April 20, 1933 filed.

May 9. Hearing had before Miss Matthews on merits. Submitted. This is an additional hearing of the hearing that was had in New York City April 20, 1933. Petitioner's brief due June 8, 1933.

May 15. Transcript of hearing of May 1, 1933 filed.

May 15. Transcript of hearing of May 9, 1933 filed.

Jun. 8. Motion for extension to 6/19/33 to file brief filed by taxpayer. 6/8/33 granted.

Jun. 20. Motion for extension to 6/20/33 to file brief filed by taxpayer. 6/20/33 granted.

Jun. 20. Brief filed by taxpayer.

1934.

Jul. 31. Memorandum opinion rendered, Annabel Matthews, Div. 13. Judgment will be entered for the respondent.

Jul. 31. Decision entered, Annabel Matthews, Div. 13.

Aug. 30. Motion for review by the whole Board with brief in support thereof filed by taxpayer.

Sep. 12. Order denying motion for Board's review entered.

Oct. 30. Stipulation of venue filed.

Oct. 30. Petition for review by U. S. Court of Appeals of D. C. with assignments of error filed by taxpayer.

Oct. 30. Proof of service filed by taxpayer.

1934.

Dec. 27. Motion for extension of 30 days to complete record filed by taxpayer.

Dec. 27. Order enlarging time to Jan. 28, 1935 for preparation of evidence and delivery of record entered.

1935.

Jan. 28. Motion for extension to 2/17/35 to complete record filed by taxpayer.

Jan. 28. Order enlarging time to Feb. 18, 1935 for preparation of evidence and delivery of record entered.

Feb. 14. Motion for extension to 3/5/35 to complete record filed by General Counsel.

Feb. 14. Order enlarging time to March 5, 1935 for preparation of evidence and delivery of record entered.

Mar. 5. Motion for extension to 3/15/35 to complete record filed by taxpayer.

Mar. 5. Order enlarging time to 3/15/35 for preparation of evidence and delivery of record entered.

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Mar. 13. Agreed statement of evidence lodged.

Mar. 13. Præcipe filed—proof of service thereon.

Mar. 14. Agreed statement of evidence approved and ordered filed.

Mar. 15. Order enlarging time to April 15, 1935 for transmission and delivery of record entered.

4 [Stamp:] Filed Mar. 16, 1929. United States Board of Tax Appeals.

United States Board of Tax Appeals.

43191.

GUANTANAMO SUGAR COMPANY, 129 Front Street, New York City, N. Y., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner

of Internal Revenue in his notice of deficiency, IT:AR:D-WGS-60D, dated January 16, 1929, and as a basis for this proceedings alleges the following:

1. The petitioner is a corporation with its principal place of business at 129 Front Street, New York City, in the State of New York.

2. The notice of deficiency, a copy of which is attached and marked Exhibit A, was mailed to the petitioner on January 16, 1929.

3. The taxes in controversy are income and excess profits taxes for the fiscal years ended September 30, 1918, September 30, 1919, and September 30, 1920, and for \$54,716.19.

4. The determination of the taxes set forth in the said notice of deficiency is based upon the following errors:

a. That proportion of repairs which were disallowed and which are now treated as capital expenditures, for the year 1918.

5 b. Denying the petitioner's contention that its excess profits taxes should be computed for the year 1920 under Sections 327 and 328.

5. The facts upon which petitioner relies as basis of this proceedings are as follows:

a. That proportion of repairs disallowed as a deduction as expense is a proper deduction under Section 214, providing for ordinary and necessary expenses.

b. That the petitioner maintains that relief should be granted under Section 327 and Section 328, for the reason that the record discloses abnormalities affecting both capital and income.

6. The petitioner prays for relief from the deficiency asserted by the respondent on the following and each of the following particulars:

a. Repairs which were treated by the respondent as capital expenditures, but in their nature are deductible as ordinary and necessary expenses.

b. That relief should be granted the petitioner under Section 327 and Section 328 on account of abnormalities affecting both capital and income.

Wherefore, petitioner prays that this board may hear and redetermine the deficiency herein alleged.

ALFRED C. FRODEL,

Counsel for Petitioner,
815 Fifteenth St., N. W.,

Washington, D. C.

COUNTY OF NEW YORK,
State of New York, ss:

John Wallpert, being duly sworn, says that he is the Secy-Treas. of the corporation above named; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

JOHN WALLPERT.

Subscribed and sworn to before me this 15th day of March, 1929.

WM. C. T. GRIES,
Notary Public.

(Copy.)

Treasury Department, Washington.

Office of Commissioner of Internal Revenue.

Address reply to Commissioner of Internal Revenue and refer to IT:AR:D. WGS-60D.

January 16, 1929.

Messrs. David A. Buckley, Jr., and Morris L. Johnston,
52 William Street,
New York, New York.

SIRS:

There is enclosed a carbon copy of a letter of this date addressed to the taxpayer whose name and address are given below. This copy is furnished in accordance with the authority conferred upon you by the taxpayer to whom the original letter has been mailed.

Respectfully,

C. B. ALLEN,
Deputy Commissioner,
By (Sd.) J. HILL, JR.,
Chief of Section.

Enclosure: copy of letter.

Name and address of taxpayer: Guantanamo Sugar Company, 129 Front Street, New York, New York.
(1155M)

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(Copy)

NP-2a.

Mailed Jan. 16, 1929.

IT:AR:D.
WGS-60D.

Guantanamo Sugar Company,
129 Front Street,
New York, New York.

SIRS:

In accordance with Section 274 of the Revenue Act of 1926, you are advised that the determination of your tax liability for the years 1918, 1919 and 1920 discloses a deficiency of \$54,716.19 for the years 1918 and 1920 and an overassessment of \$32,556.98 for the year 1919 as shown in the statement attached.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:AR:P-7. The signing of this agreement form will expedite the closing of your return by permitting an early assessment of any deficiencies and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the agreement form, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiencies.

Respectfully,

D. H. BLAIR,
Commissioner,

By (Signed) C. B. ALLEN,
Deputy Commissioner.

Enclosure: Statement. Form 886. Form 882. Schedules
1 to 18, inclusive. rar-1.

(Copy.)

Statement.

IT:AR:D.
WGS-60D.

Returns Examined.

Company.	Year ended.	Form.
Guantanamo Sugar Company	September 30, 1918	1031-1103-1120
New York, New York	September 30, 1919	1120-A
	September 30, 1920	1120-A

Tax Liability.

Year ended.	Corrected tax liability.	Tax previously assessed.	Over- assess- ment.	Deficiency.
September 30, 1918	\$140,274.17	\$138,126.22		\$2,147.95
September 30, 1919	367,443.02	400,000.00	\$32,556.98	
September 30, 1920	809,699.78	757,131.54		52,568.24
Totals.....			\$32,556.98	\$54,716.19

Bureau letters dated February 16, 1924, and December 2, 192-, have been revised, in accordance with the attached schedules.

Due consideration has been given to the issues raised in the conferences held in this office April 3, 1924, May 18, 1925, July 27, 1925 and June 12, 1928, and action taken thereon as follows:

Repairs disallowed:

The repairs proposed to be disallowed as expense in the prior letters are now allowed with the exception of those itemized herein and considered as capital expenditures.

Loss by flood damage, June 28, 1918: Allowed.

Amortization of war facilities:

The deduction for amortization has been recomputed as shown herein based on revised Engineer's report dated March 27, 1928.

10 Credit for Cuban income tax: Allowance has been made as shown herein.

Depreciation of Cane Stubble: As agreed in conference, a rate of 16-2/3rds % per annum is allowed. It appears that during the years 1913, 1914 and 1915 the company charged to surplus certain expenditures on additions and betterments, including therein the sum of \$94,127.47 representing expenditures for cane planted in new lands. This amount has been restored to the costs in the return for the purpose of computing depreciation thereon. However, from all information on file in this office it appears that costs equal at least to the above amount should have been charged

to the depreciation reserve, representing cane stubble entirely exhausted prior to the taxable years under review, and it is accordingly excluded in the computation of depreciation herein.

A carbon of this letter has been mailed to Messrs. David A. Buckley, Jr., and Morris L. Johnston, in accordance with the authorization contained in your power of attorney running to them, which is on file in this office.

The right of appeal applies only to those years in which there is a deficiency in tax as defined by Sections 273 and 283 of the Revenue Act of 1926.

The overassessment will be made the subject of a Certificate of Overassessment which will be issued through the office of the Collector of Internal Revenue for your district, under authority of Section (284(g) of the Revenue Act of 1926 and applied in accordance with the provisions of Section 284(a) of that Act.

Consent fixing period of limitation for the above taxable years, expiring December 31, 1929, is on file in this office.

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Guantanamo Sugar Company.

Year Ended September 30, 1918.

Schedule 1.

Net Income (1917 Act).

Net income as disclosed by amended return.....	\$747,945.35
As corrected.....	761,694.58
Net additions.....	<u>\$13,749.23</u>
Additions:	
(a) Depreciation of cane stubble.....	\$7,380.79
(b) Depreciation of amortized assets.....	8,670.09
(b) Capital expenditures.....	3,564.31
(c) Amortization.....	<u>33,229.39</u>
Total additions.....	52,844.58
Deductions:	
(e) Taxes paid Cuba.....	<u>39,095.35</u>
Net additions as above.....	<u>\$13,749.23</u>

Explanation of Items Changed.

(a) Depreciation deducted on return.....	\$72,749.56
Allowed (Schedule 1-A).....	<u>65,368.77</u>
Disallowed.....	<u>\$7,380.79</u>
(b) Depreciation is disallowed at average rate used in return on assets acquired prior to September 30, 1917, subject to amortization beginning January 1, 1918.	
6% of \$192,668.74 $\times$ 9/12 equals.....	<u>\$8,670.09</u>

Schedule 1—Continued.

(c) Agricultural repairs disallowed:

W. C. stool.....	\$19.24
Bathroom fixtures.....	71.16
Grindstone.....	11.22
Column.....	34.08
Toilet and sink.....	33.79
Harrows and cultivator.....	39.77
Mowing machine and grindstone.....	179.00
Spoulding plows.....	510.20
Grindstone.....	39.30
Rain gauge.....	30.62
Drill.....	18.90
Set of blocks.....	5.86

12 Brought forward.....	\$993.14
Avery plow.....	38.00
Emerson block.....	176.05
Wash basins.....	60.24
Calculating machine.....	308.36
Railroad repairs disallowed.....	42.00

\$1,617.79

Manufacturing repairs disallowed:

Steam traps.....	100.00
Ice chest.....	40.90
Wardrobe.....	40.00
Stove.....	40.82
Wash basin.....	14.30
Stove.....	26.12
Toilet.....	17.50
Washstand.....	33.05
Bathtub.....	53.15
Bathtub.....	61.79
Stove.....	32.09
One-half ton hoists.....	110.00
One-ton hoists.....	248.00
Two-ton hoists.....	176.00
Hydraulic jacks.....	140.00
Hand drill.....	12.80
Set of dies.....	17.00
Plate of lathe.....	106.00
Bench vises.....	13.00
Set of dies.....	17.00
Plates of lathe.....	61.00
Set of dies.....	34.00
Portable crane.....	77.19
Blocks.....	14.81
Hydraulic jacks.....	200.00
Blocks.....	260.00

\$1,946.52Total.....\$3,564.31

(d) Amortization is not deductible under the Revenue Act of 1917.

(e) Income taxes paid a foreign government is an allowable deduction from income under the 1917 law.

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Schedule 1-A.

Depreciation on Cane Stubble—16-2/3%.

Balance.		Depreciation to September 30, 1917.	1918.	1919.	1920.
October 1, 1917	\$381,748.42	\$141,757.79	\$63,624.74	\$63,624.74	\$63,624.74
Additions 1918.	20,928.37		1,744.03	3,488.06	3,488.06
Additions 1919.	34,129.33			2,844.11	5,688.22
Additions 1920.	65,845.36				5,487.11
	<u>\$502,651.48</u>	<u>\$141,757.79</u>	<u>\$65,368.77</u>	<u>\$69,956.91</u>	<u>\$78,288.13</u>

Schedule 2.

Net Income (1918 Act).

Net income as disclosed by Schedule 1.....	\$761,694.58
As corrected.....	<u>747,424.39</u>
Net deductions.....	\$14,270.19
Additions:	
(a) Income tax paid Cuba.....	\$39,095.35
Deduction:	
(b) Amortization.....	<u>53,365.54</u>
Net deductions as above.....	\$14,270.19

Explanation of Items Changed.

(a) Since this tax is allowed as a credit against the 1918 tax liability it is not allowed as a deduction from income.	
(b) Net income before deduction of Amortization:	
Year ended September 30, 1918—\$800,789.93	
January 1 to September 30, 1918.....	\$600,592.45
Year ended September 30, 1919—1,562,184.62	
October 1 to December 31, 1918.....	<u>390,546.15</u>
Total for January 1 to December 31, 1918....	\$991,138.60
Amortization allowance on costs incurred from April 6, 1917 to September 30, 1918, per Engineer's Report.....	\$88,067.76
Allocated to fiscal year 1918—60.596%.....	<u>53,365.54</u>
Allocated to fiscal year 1919—39.404%.....	\$34,702.22

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Schedule 3.

Invested Capital Fiscal Year 1918.

(1917 Computation.)

As reported on amended return.....	\$6,027,060.77
As corrected.....	<u>6,004,680.42</u>
Net decrease as explained below.....	\$22,380.35
Decreases:	
(a) Stock Bonus.....	\$2,500.00
(b) Adj. for 1917 income taxes.....	<u>19,880.35</u>
Total decrease.....	22,380.35
Net decrease as above.....	<u>\$22,380.35</u>

Schedule 3—Continued.

Explanation of Items Changed.

(a) Explained in Schedule 2-A (c) of Revenue Agent's report dated September 30, 1922 covering the taxable year 1917.	
(b) Taxes assessed 6/30/1916 to 12/31/16 Bureau letter 2/2/1923	\$5,620.13
Taxes 9/30/1916 to 12/31/16.....	2,810.07
Taxes 1/1/17 to 6/30/17 Bureau letter 2/2/1923.....	35,192.63
Taxes 6/30/17 to 9/30/17 *2753214 return.....	2,847.37
Previous years taxes deducted from invested capital for fiscal year 9/30/18 as follows:	
Taxes 9/30/16 to 12/31/16, deducted in full.....	2,810.07
Taxes 1/1/17 to 6/30/17, \$35,192.63 payable 12/12/17, prorated 9/20/31 months.....	28,286.55
Taxes 6/30/17 to 9/30/17 \$2,847.37 payable 3/14/18, prorated 6/18/31 months.....	1,561.46
	<u>\$32,658.08</u>
Invested capital to be reduced by Adjustment to invested capital for income tax as shown in amended return.....	12,777.73
	<u>\$19,880.35</u>

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Schedule 4.

Proof of Invested Capital.

(1917 Computation.)

Capital stock.....	\$3,000,000.00
Surplus.....	2,544,084.60
Reserve for Bad Accounts.....	20,110.83
Reserve for Federal Taxes and contingencies.....	50,000.00
	<u>\$5,614,195.43</u>
Total, balance sheet beginning of year.....	\$5,614,195.43
Additions as shown in Schedule F return.....	425,643.07
(Property account written off but not claimed as deduction from income, verified by Revenue Agent's report dated 9/30/1922)	
Total.....	<u>\$6,039,838.50</u>
Reductions:	
1917 Income Tax.....	\$32,658.08
Stock Bonus.....	2,500.00
	<u>35,158.08</u>
Total (Deduct from above).....	<u>35,158.08</u>
As shown on Schedule No. 3.....	<u>\$6,004,680.42</u>

Schedule 5.

Invested Capital Fiscal Year 1918.

(1918 Computation.)

As reported on amended return.....	\$6,027,060.77
As corrected.....	6,004,708.91
	<u>\$22,350.86</u>
Net decrease as explained below.....	\$22,350.86
Decreases:	
(a) Stock Bonus.....	\$2,500.00
(b) Adj. for 1917 Income Taxes.....	19,850.86
	<u>22,350.86</u>
Total decrease.....	<u>22,350.86</u>
Net decrease as above.....	<u>\$22,350.86</u>

Schedule 5—Continued.

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Explanation of Items Changed.

(a) Explained in Schedule 2-A Revenue Agent's report September 30, 1922.	
(b) Taxes assessed June 30, 1916, to December 31, 1916, Bureau letter February 2, 1923.....	\$5,620.13
Taxes 9/30/16.....	2,810.07
Taxes assessed 1/1/17 to 6/30/17 Bureau letter 2/2/23....	35,192.63
Taxes assessed 6/30/17 to 9/30/17, #2753214 return.....	2,847.37
Previous year's taxes deducted from invested capital for fiscal year 9/30/18 as follows:	
Taxes 9/30/16 to 12/31/16 deducted in full.....	2,810.07
Taxes 1/1/17 to 6/30/17, \$35,192.63 payable 12/12/17.	
Prorated out 293 days $\$35,192.63 \times 293/365$	28,250.52
Taxes 6/30/17 to 9/30/17, \$2,847.36 payable 3/14/18.	
Prorated out 201 days $\$2,847.37 \times 201/365$	1,568.00
	\$52,628.59
Invested capital reduced by Adjustment to invested capital for income tax as shown in amended return.....	12,777.73
Additional reduction from invested capital.....	\$19,850.86

Schedule 6.

Computation of Excess Profits Tax (1917 Act).

Net Income.....		\$761,694.58
Invested capital.....		6,004,680.42
	Income.	Tax.
Deduction 7%.....	\$420,327.63	
Exemption.....	3,000.00	
Total credit.....	\$423,327.63	
Taxable @ 20%.....	338,366.95	\$67,673.39
	\$761,694.58	

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Schedule 7.

Computation of Total Tax (1917 Act).

	Income.	Tax.
Net income.....	\$761,694.58	\$67,673.39
Excess Profits Tax.....	\$67,673.39	
Interest on U. S. obligations.....	7,891.21	
	75,564.60	
Taxable @ 2%.....	\$686,129.98	\$13,722.60
Taxable @ 4%.....	686,129.98	27,445.20
		\$108,841.19

Schedule 8.

Computation of Tax (1918 Act).

Excess Profits Tax.

Net income.....	\$747,424.39
Invested capital.....	6,004,709.91
8% of invested capital.....	480,376.79
Exemption.....	3,000.00
Credit.....	\$483,376.79

Schedule 8—Continued

	Income.	Tax.
Net income.....	\$747,424.39	
Excess profits credit.....	483,376.79	
Balance.....	\$264,047.60	
Taxable @ 30%.....	264,047.60	\$79,214.28

War Profits Tax.

Net income.....	\$747,424.39	
Credit:		
10% of \$6,004,709.91 plus \$3,000.00.....	603,470.99	
Taxable @ 80%.....	\$143,953.40	\$115,162.72
Less excess profits tax.....		79,214.28
War Profits Tax.....		\$35,948.44
Total excess profits and war profits tax.....		\$115,162.72

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Computation of Total Tax (1918 Act).

Income Tax.

Net income for taxable year.....	\$747,424.39	
Less:		
Interest on obligations of United States not exempt.....	\$7,891.21	
War-profits and excess-profits tax..	115,162.72	
Exemption.....	2,000.00	
	<u>125,053.93</u>	
Taxable at 12%.....	\$622,370.46	\$74,684.46
Total war-profits, excess-profits and income taxes.....		189,847.18
Less foreign income, war-profits and excess-profits taxes.....		39,095.35
Total tax.....		\$150,751.83

Schedule 9.

Adjustment of Tax for Fiscal Year.

Total tax under 1917 Act.....	\$108,841.19
Total tax under 1918 Act.....	150,751.83
3/12 × \$108,841.19 equals.....	\$27,210.30
9/12 × \$150,751.83 equals.....	113,063.87
Total tax for fiscal year.....	\$140,274.17
Less tax previously assessed.....	138,126.22
Additional to be assessed.....	\$2,147.95

Year Ended September 30, 1919.

Schedule 10.

Net Income.

Net income as disclosed by return.....	\$1,503,969.64
As corrected.....	1,455,391.20
Net deductions.....	\$48,578.44

Schedule 10—Continued

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Brought forward.....		\$48,578.44
Additions:		
(a) Depreciation of cane stubble.....	\$3,104.06	
(b) Depreciation of amortized assets.....	19,065.80	
(c) Capital expenditures.....	2,838.71	
Total additions.....		<u>25,008.57</u>
Deductions:		
(d) Depreciation on items restored.....	\$272.98	
(e) Amortization.....	73,314.13	
Total deductions.....		\$73,587.01
Net deductions as above.....		<u>\$48,578.44</u>

Explanation of Items Changed.

(a) Depreciation of cane stubble deducted on return.....		\$73,060.97
Allowed (Schedule 1-A).....		<u>69,956.91</u>
Disallowed.....		\$3,104.06
(b) Depreciation at average rate used on return is disallowed on assets subject to amortization as follows:		
1917 and 1918 total costs.....	\$362,445.35	
From October 1 to December 31, 1918 @ 6¼%.....		\$5,663.21
1917 and 1918 amortization.....	\$88,067.76	
Salvage value.....	1,116.76	
Total.....	\$89,184.51	
From January 1 to September 30, 1919 @ 6¼%.....		4,180.52
One-half 1919 total costs \$147,553.17 @ 6¼%.....		<u>9,222.07</u>
Total.....		\$19,065.80
(c) Agricultural repairs to be capitalized:		
Urinals.....	\$16.06	
Toilets.....	18.68	
Stoves.....	77.23	
Wash basin, mirror and — ...	81.85	
Bathtub, washbasin and toilet.....	78.11	
20 Washstand.....	\$23.30	
P-lows.....	70.00	
Avery plow.....	26.54	
Grindstones.....	93.53	
Iron blocks.....	18.38	
Wash basin.....	15.50	
Motor.....	60.00	
		<u>\$579.18</u>
Manufacturing repairs:		
Stove.....	\$39.00	
Stove.....	35.97	
Two ton crane.....	360.00	
Lathe chuck.....	100.00	
Parts for chuck.....	140.00	
Hatchet Braces.....	21.00	
Set of dies.....	17.00	
Hydraulic jack.....	140.00	
Forges.....	104.50	
Pair of triple blocks.....	130.00	
Drill.....	15.56	
Feeding machine.....	225.00	

Schedule 10—Continued.

Tube press.....	60.50	
Bench vise.....	47.00	
Boring machine.....	520.00	
Sets for drill.....	304.00	
		2,259.53
Total.....		\$2,838.71
(d) Depreciation on assets disallowed as expense.		
Agricultural repairs 1918.....	\$1,575.95	
1919 (1/2)....	289.59	
Depreciation at 2.1% on.....	\$1,865.54	39.18
Manufacturing repairs 1918.....	1,946.62	
1919 (1/2)....	1,129.77	
		233.80
Total.....		\$272.98
(e) Amortization allowed on costs incurred prior to September 30, 1918 and deductible in 1919 (Schedule 2 (b)).....		\$34,702.22
Allowed on costs incurred in 1919 as shown by Engineer's report dated March 27, 1928.....		72,091.30
Total allowance for 1919.....		\$106,793.52
Deduction taken on return.....		33,479.39
Additional allowance.....		\$73,314.13

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Schedule 11.

Invested Capital.

Invested Capital as disclosed by return.....		\$6,378,059.41
As corrected.....		6,388,385.50
Net adjustment.....		\$10,326.09
Additions:		
(a) Repairs disallowed 1918.....	\$3,564.31	
(b) Depreciation of cane stubble.....	7,380.79	
(c) Depreciation of amortized assets.....	8,670.09	
(d) 1918 Income Tax.....	13,716.08	
	Total	\$33,331.27
Deductions:		
(e) Amortization 1918.....	\$20,136.15	
(f) 1917 Income Tax.....	369.03	
(g) Stock bonus.....	2,500.00	\$23,005.18
Net adjustment as above.....		\$10,326.09

Explanation of Items Changed.

- (a) The deductions taken for repairs in 1918 and restored to taxable income for that year are added to invested capital for 1919.
- (b) and (c) Disallowed depreciation for 1918 is restored to invested capital for 1919.
- (d) The deduction from surplus on account of accrual of 1918 Income tax is adjusted as follows:

Correct total tax for 1918.....		\$140,274.17
Payable:		
One-fourth February 25, 1919 averaged	218 days	
One-fourth March 15, 1919 averaged	200 days	
One-fourth June 15, 1919 averaged	108 days	
One-fourth September 15, 1919 averaged	16 days	
Total average 135.5 days		
\$140,274.17 × 135.5 ÷ 365 equals.....		\$52,074.38
Adjustment made on return.....		\$65,790.46
Amount to be restored.....		\$13,716.08

Schedule 11—Continued.

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(e) Amortization allowed January 1 to September 30, 1918:	\$53,365.54
Amount deducted on return.....	33,229.39
Additional deduction from surplus.....	\$20,136.15
(f) Additional taxes for 1917 assessed May 1923 are deducted from surplus.	
(g) This item is explained in Schedule 2-A (c) of Revenue Agent's report for the taxable year 1917.	

Schedule 12.

Proof of Invested Capital.

Capital stock.....	\$3,000,000.00
Surplus.....	2,784,956.77
Surplus reserves:	
Contingencies.....	\$261,000.00
Bad debts.....	5,479.42
Total.....	266,479.42
Total.....	\$6,051,436.19
Additions:	
Schedule F of return.....	\$426,643.07
Agricultural repairs 1918.....	1,575.79
Railroad repairs 1918.....	42.00
Manufacturing repairs 1918.....	1,946.52
Cane stubble depreciation 1918.....	7,380.79
Depreciation 1918.....	8,670.09
Total.....	\$6,496,694.45
Deductions:	
Amortization.....	\$53,365.54
Stock bonus.....	2,500.00
Additional tax 1917.....	369.03
1918 taxes.....	52,074.38
Total (deduct from above).....	108,308.95
As shown on Schedule 11.....	\$6,388,385.50

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Schedule 13.

Computation of Profits Taxes.

1918 Rates.		Income	Tax
Net Income.....		\$1,455,391.20	
Invested capital.....	\$6,388,385.50		
%.....	511,070.84		
Exemption.....	3,000.00	514,070.84	
Balance.....		\$941,320.36	
Taxable @ 30%.....		763,606.26	\$229,081.88
Taxable @ 65%.....		177,714.10	\$115,514.16
Excess Profits Tax at 1918 rates.....			\$344,596.04
Net Income.....		\$1,455,391.20	
10% of Invested Capital....	\$638,838.55		
Exemption.....	3,000.00	641,838.55	
Taxable @ 80%.....		\$813,652.65	\$650,842.12
Excess Profits Tax.....			344,596.04
War Profits Tax.....			306,246.08
Total Profits Taxes at 1918 Rates.....			\$650,842.12

Schedule 13—Continued.

	1919 Rates.	Income	Tax
Net Income.....		\$1,455,391.20	
Excess Profits Credit.....		514,070.84	
Balance.....		\$941,320.36	
Taxable @ 20%.....		763,606.26	\$152,721.25
Taxable @ 40%.....		177,714.10	\$71,085.64
Total Excess Profits Tax at 1919 Rates.....			\$223,806.89
3/12 × \$650,842.12 equals.....		\$162,710.53	
9/12 × \$223,806.89 equals.....		167,855.17	
Total Profits Taxes for fiscal year.....			\$330,565.70

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Schedule 14.
Computation of Total Tax.

Net income.....	\$1,455,391.20	
Interest on U. S. Obligations.....	\$25,018.98	
Profits Taxes.....	330,565.70	\$330,565.70
Exemption.....	2,000.00	357,584.68
Balance subject to income tax.....	\$1,097,806.52	
3/12 Tax at 1918 Rate, 12%.....		32,934.20
9/12 Tax at 1919 Rate, 10%.....		82,335.49
Total Tax.....		\$445,835.39
Credit for Cuban Income Tax.....		78,392.37
Total tax assessable.....		\$367,443.02
Previously assessed.....		400,000.00
Overassessed.....		\$32,556.98

Schedule 15.

Year ended September 30, 1920.

Net Income.

Net income as disclosed by return.....	\$2,757,359.09
As corrected.....	2,882,830.70
Net additions.....	\$125,471.61
Additions:	
(a) Amortization adjusted.....	\$33,204.20
(b) Depreciation on cane.....	79,170.84
(c) Depreciation on amortized assets.....	11,365.54
(d) Capital expenditures.....	2,231.01
Total additions.....	\$125,971.59
Deduction:	
(e) Depreciation on assets disallowed as expense.....	499.98
Net additions as above.....	\$125,471.61

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Explanation of Items Changed.

(a) Amortization deducted on return.....	\$33,479.39
Allowed on costs incurred during year in accordance with Engineer's report dated March 27, 1928.....	275.19
Balance disallowed.....	\$33,204.20

Schedule 15—Continued.

(b) Cane stubble deducted on return.....		\$157,458.97	
Allowed as shown in Schedule 1-A.....		78,288.13	
Balance disallowed.....		\$79,170.84	
(c) Depreciation is disallowed at the average rate used in the return on assets subject to amortization as follows:			
1917 amortized costs.....	\$46,593.16		
1918 amortized costs.....	41,474.60		
1919 amortized costs.....	72,091.30		
Salvage value.....	1,642.47		
½ of 1920 total costs.....	563.26		
	\$162,364.79 @ 7%	\$11,365.54	
(d) Agricultural repairs:			
To be capitalized:			
Stoves.....	\$92.50		
Lavatory.....	226.16		
Stove.....	28.98		
Plow.....	35.00		
Cultivator.....	68.02		
8 Plows.....	205.14		
6 Plows.....	128.60		
5 Cultivators.....	150.55		
Stove.....	41.75		
Refrigerator.....	27.04		
			803.74
Manufacturing repairs:			
To be capitalized:			
Steam traps.....	360.00		
Machine to turn valves.....	160.00		
Toilet.....	22.75		
Bathtub.....	47.30		
Circular saw.....	100.00		
Stove.....	42.33		
Stove.....	41.29		
Chasers.....	25.86		
Tube Invertor.....	62.10		
Nipple Machine.....	230.00		
Key seat machine.....	165.64		
Tube welder.....	150.00		
			1,427.27
Total.....			\$2,231.01

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(e) Depreciation on assets disallowed as expense in prior years.			
Agricultural 1918.....	\$1,575.79		
1919.....	575.18		
1920 (½).....	401.87		
Railroad repairs 1918.....	42.00		
Manufacturing repairs 1918.....	1,946.52		
1919.....	2,259.53		
1920 (½).....	713.64		
Depreciation at 6.65% on.....	\$7,518.53		\$499.98

Schedule 16.

Invested Capital.

Invested Capital as disclosed by return.....	\$7,244,435.11	
As corrected.....	7,346,591.85	
Net additions.....	\$102,156.74	

Schedule 16—Continued.

Additions:		
(a) Depreciation of cane stubble.....	\$10,484.85	
(b) Depreciation of amortized assets.....	27,735.89	
(c) Repairs disallowed.....	6,403.02	
(d) 1918 Income Tax overpaid.....	111,061.63	
(e) 1919 Income tax adjusted.....	43,694.85	
Total additions.....		\$199,380.24
Deductions:		
(f) Depreciation allowed in 1919.....	\$272.98	
(g) Amortization.....	93,450.28	
(h) 1917 Income Tax.....	369.03	
(i) Stock bonus.....	2,500.00	
(j) Inadmissible Assets.....	631.21	
Total deductions.....		\$97,223.50
Net additions as above.....		\$102,156.74
27	Explanation of Items Changed.	
(a) Depreciation of cane stubble disallowed as deduction:		
1918.....	\$7,380.79	
1919.....	3,104.06	
	\$10,484.85	
(b) Depreciation of amortized assets disallowed as deduction:		
1918.....	\$8,670.09	
1919.....	19,065.80	
	\$27,735.89	
(c) Repairs restored to income as follows:		
1918.....	\$3,564.31	
1919.....	2,838.71	
	\$6,403.02	
(d) 1918 Income Taxes as corrected.....		\$140,274.17
Paid on returns.....	\$113,209.58	
	138,126.22	251,335.80
		\$111,061.63
(e) 1919 Income Taxes as corrected.....		\$367,443.02
Prorated from due dates of installments:		
\$367,443.02 × .420082.....		154,356.20
Deducted on return.....		198,051.05
		\$43,694.85
(f) Depreciation allowed in 1919 on items restored to capital assets.....		
(g) Amortization deducted from surplus returned.....		\$66,708.78
Amortization allowed:		
1918.....	\$53,365.54	
1919.....	106,793.52	160,159.06
Additional to be deducted.....		\$93,450.28
(h) Additional tax for 1917 assessed May 1923.		
(i) This item is explained in Schedule 2-A (c) of Revenue Agent's report for the year 1917.		

Schedule 16—Continued

28 (j) Computation of adjustment for inadmissibles:

Date Purchased	Amount.	Days Held	Average
August 23, 1920.....	\$97,375.00	39	\$10,376.02
August 30, 1920.....	48,687.50	32	4,256.83
August 31, 1920.....	146,062.50	31	12,371.41
September 8, 1920.....	68,162.50	23	4,283.44
September 21, 1920.....	9,752.00	10	266.44
			<u>\$31,554.14</u>
	September 30, 1919	September 30, 1920	
Total admissible assets reported.....	\$8,207,118.57	\$8,906,644.46	
Additions:			
Repairs disallowed.....	6,403.02	8,634.03	
Depreciation of cane stubble.....	10,484.85	89,655.69	
Depreciation of amortized assets.....	27,735.89	39,100.43	
1918 Tax overpayment.....	111,061.63	111,061.63	
1919 Tax overpayment.....		27,412.61	
	<u>\$8,362,803.96</u>	<u>\$9,182,508.85</u>	
Deductions:			
Amortization.....	93,450.28	60,246.08	
Depreciation of repairs restored.....	272.98	772.96	
	<u>\$93,723.26</u>	<u>\$61,019.04</u>	
Total admissible assets as corrected...	\$8,269,080.70	\$9,121,489.81	
Average admissible assets.....		8,695,285.25	
Average inadmissible assets.....		31,554.14	
Total.....		<u>\$8,726,839.39</u>	
Percentage of Inadmissible to Total Assets .0036157			
Invested Capital before adjustment for inadmissible assets....		7,373,251.31	
.0036157 × \$7,373,251.34 equals.....		26,659.46	
Amount deducted on return.....		26,028.25	
Additional deduction.....		<u>\$631.21</u>	

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Schedule 17.
Proof of Invested Capital.

Capital Stock.....	\$3,000,000.00
Surplus.....	3,537,482.08
Surplus reserves:	
Bad debts.....	21,610.83
Taxes and contingencies.....	483,778.43
Total.....	<u>\$7,042,871.34</u>
Additions:	
Schedule F of return.....	425,643.07
Overassessment 1918.....	111,061.63
Depreciation cane stubble 1918.....	10,484.85
Depreciation amortized assets.....	27,735.89
Agricultural repairs.....	2,154.97
Railroad repairs.....	42.00
Manufacturing repairs 1918 and 1919.....	4,206.05
	<u>581,328.46</u>
	<u>\$7,624,199.80</u>

Schedule 17—Continued.

Deductions:

Bonus stock.....	\$2,500.00	
Additional tax 1917.....	369.03	
1919 taxes.....	154,356.20	
Additional depreciation.....	272.98	
Amortization adjustment.....	93,450.28	
Inadmissibles.....	26,659.46	
Total (deduct from above).....		\$ 277,607.95
As shown on Schedule 16.....		\$7,346,591.95

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Schedule 18
Computation of Excess Profits Tax.

Net income.....	\$2,882,830.70	
Invested Capital.....	7,346,691.85	
8% of Invested Capital.....	587,727.35	
Exemption.....	3,000.00	Tax
Excess Profits Credit.....	\$590,727.35	
Taxable @ 20%.....	878,591.02	\$175,718.20
Taxable @ 40%.....	1,413,512.33	565,404.93
	\$2,882,830.70	\$741,123.13

Income Tax.

Net Income.....	\$2,882,830.70	
Interest on U. S. obligations.....	\$8,180.82	
Excess Profits Tax.....	741,123.13	
Exemption.....	2,000.00	751,303.95
Balance subject to tax.....	\$2,131,526.75	
Income tax @ 10%.....		\$213,152.68
Total tax.....		\$954,275.81
Less credit for Cuban Income Tax.....		144,576.03
Total tax assessable.....		\$809,699.78
Previously assessed.....		757,131.54
Additional to be assessed.....		\$52,568.24

31 [Stamp:] United States Board of Tax Appeals.
Filed May 3, 1929.

United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Answer.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income and profits taxes for the fiscal years ended September 30, 1918 and September 30, 1920, in the aggregate amount of \$54,716.19.

4. a. and b. Denies that the Commissioner erred in the determination of the said deficiency as alleged in subdivisions a. and b. of paragraph 4 of the petition.

5. a. and b. Denies the allegations contained in subdivisions a. and b. of paragraph 5 of the petition.

The Respondent moves that the petition in so far as it relates to the fiscal year ended September 30, 1919 be dismissed for the reason that the deficiency notice from which the petitioner appealed did not determine a deficiency for that year.

Denies generally and specifically each and every allegation contained in the petition of the above-named taxpayer not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed)

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

Of Counsel:

JAMES L. BACKSTROM,

Special Attorney, Bureau of Internal Revenue.

32 [Stamp:] U. S. Board of Tax Appeals. Filed Jan.
28, 1932.

United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, 129 Front Street, New York
City, N. Y., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Amended Petition.

The above-named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, IT: AR: D-WGS-60D, dated January 16, 1929, and as a basis for this proceeding alleges the following:

1. The petitioner is a corporation with its principal place of business at 129 Front Street, New York City, in the State of New York.

2. The notice of deficiency, a copy of which is attached and marked Exhibit "A", was mailed to the petitioner on January 16, 1929.

3. The taxes in controversy are income and excess profits taxes for the fiscal years ended September 30, 1918, September 30, 1919, and September 30, 1920, and for \$54,716.19.

4. The determination of the taxes set forth in the said notice of deficiency is based upon the following errors:

(a) Failure to restore to the invested capital of the petitioner the sum of \$768,287.25 written off petitioner's
33 books in 1911 and not included in invested capital in returns filed by the petitioner.

5. The facts upon which petitioner relies as basis of this proceeding are as follows:

(a) In December 1911 the petitioner, by charge to surplus, reduced the value of tangible assets on its books from their cost and book value by the following amounts:

Agricultural building	\$39,114.26
Fences	8,532.59
Roads and bridges	16,641.64
Carts	6,659.27

Agricultural tools & Implements.....	2,643.03
Steam plow	3,342.50
Batey building	26,181.87
Railway road bed	68,877.36
Factory machinery	77,459.48
Distillery	12,000.00
Guantanamo R. R. Co. common stock..	465,457.81
Lands	41,377.44
Total	<u>\$768,287.25</u>

Wherefore, the petitioner prays that this Board may hear the proceedings and determine:

(a) That the sum of \$768,287.25 shall be restored to the invested capital of the petitioner for each of the fiscal years ended September 30, 1918, September 30, 1919 and September 30, 1920.

Respectfully submitted,

(Signed) DAVID A. BUCKLEY, JR.,
Counsel for Petitioner,
 406 Southern Building, Washington, D. C.

34 COUNTY OF NEW YORK,
State of New York, ss:

John Wallpert, being duly sworn, says that he is the Secretary-Treasurer of the corporation above-named; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

(Signed) JOHN WALLPERT.

Subscribed and sworn to before me this 23rd day of January, 1932.

(Signed) MATHILDA C. STRAUB,
 [SEAL.] *Notary Public.*

35 [Stamp:] Received Feb. 10, 1932. U. S. Board of
 Tax Appeals.

[Stamp:] United States Board of Tax Appeals. Filed
 Feb. 10, 1932.

United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Answer to Amended Petition.

Now comes the Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the amended petition of this taxpayer admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2.

3. Admits that the taxes in controversy are income and excess profits taxes for the fiscal years ended September 30, 1918, and September 30, 1920, in the amount of \$54,716.19. Denies that the income taxes for the fiscal year ended September 30, 1919 are in controversy for the reason that the deficiency notice from which this appeal is taken did not propose a deficiency for said fiscal year ended September 30, 1919.

4-(a). Denies that the Commissioner erred as stated in paragraph 4-(a).

5-(a). Denies the allegations contained in paragraph 5-(a).

Denies generally and specifically each and every allegation contained in the taxpayer's amended petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Board redetermine the amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, plus any additional amount which may arise from the correction of any error or errors that may have been committed by the Commissioner. Claim is hereby asserted for the increased deficiency, if any, resulting from such redetermination.

(Signed)

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

Of Counsel:

R. P. HERTZOG,

Special Attorney, Bureau of Internal Revenue.

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United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Richard S. Holmes, Esq., for the petitioner.

Bruce A. Low, Esq., for the respondent.

Memorandum Opinion.

MATTHEWS:

This proceeding is for the redetermination of deficiencies in income and excess profits taxes asserted against the petitioner for the fiscal years ended September 30, 1918 and September 30, 1920, in the respective amounts of \$2,147.95 and \$52,568.24. The sole issue presented for our determination is whether the petitioner is entitled to have restored to its invested capital for the taxable years the sum of \$457,319.02, representing the alleged value of certain stock of the Guantanamo Railroad Company owned by the petitioner, which stock was included in the assets
37 written off the petitioner's books on December 30, 1911, and which has never been restored to surplus.

Petitioner is a corporation organized in 1905 under the laws of the State of New Jersey. It is engaged in the business of producing and selling raw sugar and owns and operates a number of sugar estates in Cuba. The Guantanamo Railroad Company has been operated as an integral part of the petitioner's business since 1905. When the petitioner corporation was organized it acquired 5,630 shares of the common stock of the Guantanamo Railroad Company in exchange for shares of its own common stock and the stock thus acquired was set up on the petitioner's books at \$75 a share, or \$422,250. Petitioner subsequently purchased 1,066 additional shares of stock of the Guantanamo Railroad Company at a total cost of \$35,069.02. As of February 20, 1908, petitioner's books showed the total cost of 6,696 shares of the common stock of the Guantanamo Railroad Company to be \$457,319.02. This stock has never been sold and is still owned by the petitioner.

Until 1907 there was no railroad in Guantanamo Valley other than the line which had been built many years previously and which was being operated by the Guantanamo Railroad Company. It is a standard guage road, running from Guantanamo east to Jamaica and west to Soledad and is equipped to move freight and to operate passenger trains. It hauls all the cane and the raw products of the petitioner corporation. The petitioner has never received any dividends from the Guantanamo Railroad Company but operated the railroad for the benefit of its sugar business after it acquired a controlling interest in the stock in June, 1905.

38 The minute book of the Guantanamo Railroad Company discloses the net income of the company for the years 1900 to 1905, inclusive, and also shows that dividends were declared for those years, as follows:

Year.	Net income.	Dividend.
1900	\$40,180.68	5½%
1901	23,880.57	5%
1902	47,192.94	3%
1903	11,837.88	None
1904	11,104.13	"
1905	59,722.24	"

In 1907 a competing railroad was constructed and thereafter the sugar estates which were not owned by the petitioner began to ship their products over the new line. The petitioner continued to use the Guantanamo Railroad Company in its own business and advanced considerable sums of money to that company from time to time until by the end of 1918 petitioner had loaned the Guantanamo Railroad Company approximately \$1,000,000, which amount is still outstanding. The Guantanamo Railroad Company has paid no dividends for any period since the year 1902.

At a meeting held on December 13, 1911, it was resolved by the directors of the petitioner corporation that the cost of the shares of the Guantanamo Railroad Company should be carried on the books at a nominal value of \$1 and it was further resolved that there should be written off the cost of property the total sum of \$768,287.25, of which amount the sum of \$465,457.81 represented the shares of stock of the Guantanamo Railroad Company owned by the petitioner. In accordance with this resolution

the several property accounts were reduced and there was charged to surplus as of December 30, 1911 the total sum of \$768,287.25. This amount was not restored to or
39 included in the petitioner's invested capital in the years involved herein. In the returns filed by the petitioner for the taxable years the assets thus written off were not claimed as a part of the petitioner's invested capital. The petitioner is now claiming that it has the right to restore to its invested capital for the years involved in this proceeding the sum of \$457,319.02, representing a part of its investment in the stock of the Guantanamo Railroad Company, which amount was included in the total assets written off in December, 1911, under the circumstances described above. Petitioner is not asking for the restoration of the full amount of \$465,457.81 for the reason that the additional purchases making up the difference between these two sums were comparatively small in amount and difficult to prove. It was agreed at the hearing that the discrepancy of approximately \$8,000 would be admitted by counsel for the petitioner and the difference waived on the understanding that counsel for the respondent would not raise any objection relative to any inconsistency of the pleadings with the petitioner's records on that point.

The issue presented herein was raised for the first time in the amended petition filed in this proceeding.

Section 325 (a) of the Revenue Act of 1918 provides that the term "tangible property" means stocks, bonds, notes and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property. Section 326 (a) provides in part that the term "invested capital" means:

40 Sec. 326. (a) (2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: * * *

Article 842 of Regulations 45 provides as follows:

Art. 842. Surplus and undivided profits: property paid in and subsequently written off. Where tangible or intangible

property has been paid in to a corporation for stock or shares or as paid-in surplus, and has subsequently been in whole or in part written off the books, the amount so written off may upon evidence satisfactory to the Commissioner be restored to the capital or surplus account subject to the following limitations:

(1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence, or depletion; and

(2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.

In Central Consumers Wine & Liquor Co., 1 B. T. A. 1190, this Board held that under the Revenue Acts of 1917 and of 1918 actual values only may be included in invested capital, and the burden of proving actual value is on the taxpayer. The following quotation is taken from that decision, at page 1193:

The taxpayer contends that to require proof of value other than the issue of capital stock fully paid and non-assessable is to presume irregularity amounting to fraud in the issue of such stock. Congress, however, has provided that invested capital includes only actual cash, *actual* cash value of tangible property and intangible property bona fide paid in for stock or shares in an amount not exceeding the *actual* cash value of such property, the par value of the stock or shares issued therefor, or, with respect to intangible property, in the aggregate 25 per cent of
41 the par value of the total stock or shares of the corporation outstanding. It is clear that Congress, in the above provisions, was carefully providing for the inclusion of actual values only and must have intended to impose the burden of proof of such value upon the taxpayer claiming the invested capital. * * *

Before assets which have been written off the books of a corporation may be restored to its surplus for a taxable period it must be established that such assets are in existence and are still owned by the corporation at the beginning of the period in question, and also that the assets have retained their invested capital value. It is not questioned

that the petitioner continued to own the stock during the taxable periods involved herein but it has not been shown that this stock continued to be valuable. So long as the Guantanamo Railroad Company had the monopoly of the railroad business in Guantanamo Valley its stock appeared to be marketable. Between September, 1905 and February, 1908, more than 1,000 shares were purchased by the petitioner at a cost of from \$31 to \$35 per share. But after a competing railroad was constructed in 1907 and its former patrons began to ship their products over the new line the situation changed. The petitioner continued to use the old line as an integral part of its business but the old line was not patronized to any considerable extent by the other sugar estates and it became necessary for the petitioner to advance large sums of money to the Guantanamo Railroad Company. There is nothing in the record to indicate that the petitioner's shares of stock of the Guantanamo Railroad Company were worth more than the nominal value of \$1 at which they were entered on the

42 books in 1911. No dividends had been paid by the Guantanamo Railroad Company for any period since the year 1902 and its liability to the petitioner corporation on account of advances made from time to time had increased until it amounted to approximately \$1,000,000 by the end of 1918. Presumably the petitioner carried the indebtedness on its books as an asset which would be reflected in its surplus account. So far as the record discloses, the total assets of the Guantanamo Railroad Company were not in excess of this indebtedness so that the petitioner was amply justified in writing down its assets in accordance with the resolution of its directors dated December 13, 1911. Clearly, the petitioner has failed to show that it is entitled to have restored to its invested capital for the taxable years the amount written off in 1911 on account of its investment in the stock of the Guantanamo Railroad Company.

Judgment will be entered for the respondent.

Enter.

Entered Jul. 31, 1934.

43 United States Board of Tax Appeals, Washington.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Decision.

Pursuant to the determination of the Board, as set forth in its report promulgated memorandum opinion entered July 31, 1934, it is ordered and decided: That there are deficiencies of \$2,147.95 and \$52,568.24 for the fiscal years ended September 30, 1918 and September 30, 1920, respectively.

Enter.

(Signed) ANNABEL MATTHEWS,
Member.

[Seal U. S. Board of Tax Appeals.]

Entered Jul. 31, 1934.

44 [Stamp:] United States Board of Tax Appeals.
Filed Oct. 30, 1934.

United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Agreement for Review by the United States Court of Appeals for the District of Columbia.

It is agreed between the parties to these proceedings by their respective undersigned attorneys, that, pursuant to Section 1002 (d) of the Revenue Act of 1926, as amended by Section 519 of the Revenue Act of 1934, the decision of the United States Board of Tax Appeals in the above-

named proceedings may be reviewed by the United States Court of Appeals for the District of Columbia.

RICHARD S. HOLMES,
Counsel for Petitioner,
42 Broadway, New York, N. Y.
FRANK J. WIDEMAN,
Assistant Attorney General,
Counsel for Respondent.

45 [Stamp:] U. S. Board of Tax Appeals. Filed Oct.
30, 1934.

United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,
against

THE COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition for Review.

To the Honorable, the Judges of the United States Court of Appeals for the District of Columbia:

Comes now, Guantanamo Sugar Company, the petitioner above named, and the petitioner on review herein, being aggrieved by a decision and order of redetermination of the United States Board of Tax Appeals rendered against it on the 31st day of July, 1934, in a proceeding entitled "Guantanamo Sugar Company, Petitioner, against The Commissioner of Internal Revenue, Respondent", No. 43191, on the Docket of said Board, and respectfully submits this its petition for review of said decision and order by the United States Court of Appeals for the District of Columbia, which Court petitioner hereby designated to be the court in which it seeks review of said decision and order in accordance with the agreement of counsel submitted herewith, and respectfully shows upon information and belief as follows:

Statement of the Case.

1. Petitioner on review is a corporation duly organized and existing under and by virtue of the laws of the State of New Jersey and has its principal office and place of business at No. 129 Front Street, in the Borough of Manhattan, City, County and State of New York. Respondent on review is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

2. The questions involved in the case at bar are, first whether petitioner is entitled to have restored to its invested capital for the fiscal years ended September 30, 1918 and September 30, 1920, the actual cash value of 5,630 shares of the capital stock of the Guantanamo Railroad Company paid in to petitioner at the time of its organization for shares of its stock and owned by petitioner during said fiscal years which shares were included in assets written off on petitioner's books to the value of \$1.00 on the 30th day of December, 1911, and the actual cash value of which had never been restored to surplus; second, the actual cash value of said 5,630 shares of stock of the Guantanamo Railroad at the time the same were paid in to petitioner in exchange for shares of its stock; third, whether petitioner is entitled to have restored to its invested capital for the fiscal years ended September 30, 1918, and September 30, 1920, the sum of \$35,069.02, the actual cost to petitioner of 1,066 shares of the stock of said Guantanamo Railroad Company purchased by petitioner between September 30, 1905 and February 20, 1908, and owned by petitioner during said fiscal years, which shares were included in the assets written off to the sum of \$1.00 on the books of petitioner as of December 30, 1911, and the cost of which had never been restored to surplus.

3. Petitioner is a New Jersey corporation and during the fiscal years above mentioned was and since the year 1905 had been engaged in the business of producing and selling raw sugar in the Republic of Cuba, owning and operating in connection with its business a number of sugar estates, in the vicinity of Guantanamo in said Republic of Cuba. The Guantanamo Railroad Company was and is a corporation duly existing under and by virtue of

the laws of — Republic of Cuba and owns a standard guage railroad running from Guantanamo east to Jamaica and west to Soledad in said Republic of Cuba.

4. At the time of the organization of petitioner, it acquired 5,630 shares of the common stock of said Guantanamo Railroad Company, together with certain sugar estates and other properties in exchange for the issue of 39,990 shares of its common stock of the par value of \$100 each. The stock of the Guantanamo Railroad Company so acquired by petitioner was set up on its books at a valuation of \$75 a share, or for \$422,250. Petitioner subsequently purchased 1,066 additional shares of the common stock of said Guantanamo Railroad Company at a total cost of \$35,069.02, making the total value of said shares of stock of Guantanamo Railroad Company as carried on the books of petitioner prior to December 30, 1911, the sum of \$457,319.02. Said shares of stock have never been sold and during the fiscal years here involved were, and still are, owned by petitioner.

5. Pursuant to a resolution of the Board of Directors duly adopted on the 13th day of December, 1911,
48 said shares of stock of Guantanamo Railroad Company (together with certain other property not material to the determination of these issues), were written down on the books of petitioner to the value of One Dollar (\$1.00) and the surplus of petitioner was reduced accordingly; that the amount so written off, namely, \$457,319.02 has never been restored to the surplus of petitioner and was not included in the computation of petitioner's invested capital for the fiscal years ended September 30, 1918 and September 30, 1920.

6. That by reason of such write-off petitioner's invested capital for said fiscal years was arbitrarily and unwarrantably reduced and the excess profits taxes paid by petitioner for said fiscal years were arbitrarily and unwarrantably increased.

7. That after audit of the income and excess profits tax returns of petitioner for said fiscal years ended September 30, 1918 and September 30, 1920, respondent determined a deficiency in income and excess profits taxes in the amount of \$2,147.95 for said calendar year ended September 30, 1918, and in the amount of \$52,568.24 for the fiscal year ended September 30, 1920. Upon appeal to the United

States Board of Tax Appeals pursuant to the provisions of the statute in such cases made and provided, said Board has affirmed the determination of respondent and on the 31st day of July, 1934, said Board rendered a decision and entered an order determining the deficiencies for said fiscal years in the amounts above set forth; that by order dated the 12th day of September, 1934, said Board denied a motion made by petitioner to have the memorandum decision of the Board reviewed by the whole Board.

49 Your petitioner avers and believes that in rendering its decision and entering its order here sought to be reviewed, errors were committed by said United States Board of Tax Appeals to the damage and prejudice of petitioner as follows:

Assignment of Errors.

1. The Board erred in determining that the value of 5,630 shares of the stock of Guantanamo Railroad Company paid in to petitioner at the time of its organization for the issue of petitioner's stock or shares to be included in the invested capital of petitioner for the fiscal years ended September 30, 1918, and September 30, 1920, was the sum of One Dollar (\$1.00), to which the same had been written down on the 30th day of December, 1911, instead of the actual cash value of said shares of stock at the time the same were paid in to petitioner.

2. The Board erred in holding as a matter of law that because petitioner failed to prove that said 5,630 shares of stock continued to be valuable, the value of the same at the time of acquisition may not be restored to the invested capital of petitioner for the fiscal years here involved.

3. The Board erred in holding as a matter of law that the actual value of said 5,630 shares of stock of Guantanamo Railroad Company when acquired may not be restored to the invested capital of petitioner for said fiscal years because said shares had been written down on the 30th day of December, 1911, to the sum of One Dollar (\$1.00).

50 4. The Board erred in holding as a matter of law that petitioner was not entitled to have included in its invested capital for said fiscal years the actual value of said 5,630 shares of stock of Guantanamo Railroad Company held by petitioner during each of said fiscal

years, and bona fide paid in to petitioner for the stock or shares of petitioner, at the time of such payment.

5. The Board erred in holding as a matter of law that the actual cost to petitioner of 1,066 shares of the stock of said Guantanamo Railroad Company, purchased by petitioner between the 30th day of September, 1905 and the 20th day of February, 1908, may not be restored to the invested capital of petitioner for the fiscal years here involved, for the reason that said shares together with other shares had been written off by petitioner on the 30th day of December, 1911, to the sum of One Dollar (\$1.00).

6. The Board erred in holding as a matter of law that petitioner was not entitled to have included in its invested capital for said fiscal years the actual cost to petitioner of 1,066 shares of the stock of Guantanamo Railroad Company purchased by petitioner between the 30th day of September, 1905 and the 20th day of February, 1908, and held by petitioner during each of said fiscal years.

7. The Board erred in failing to find as a matter of fact that the actual cash value of said 5,630 shares, paid in to petitioner for its stock or shares at the time of such payment was the sum of \$75.00 a share, or the total sum of \$422,250.

8. The Board erred in failing to find what was the actual cash value of said 5,630 shares of stock of Guantanamo Railroad Company paid in to petitioner for its stock of shares, at the time of such payment.

9. The Board erred as a matter of law and fact in holding that petitioner was not entitled to have restored to its invested capital for the fiscal years ended September 30, 1918 and September 30, 1920, the sum of \$457,319.02, the cost and the actual cash value of 6,696 shares of stock of Guantanamo Railroad Company at the time of the acquisition of the shares by petitioner and owned by petitioner during said fiscal years.

10. The Board erred in ordering and determining that there was a deficiency in income and excess profits taxes of petitioner for the fiscal year ended September 30, 1918, in the sum of \$2,147.95.

11. The Board erred in ordering and determining that there was a deficiency in income and excess profits taxes of petitioner for the fiscal year ended September 30, 1920, in the sum of \$52,568.24.

12. The Board erred in denying the motion made by petitioner for the review by the whole Board of the memorandum opinion, rendered the 31st day of July, 1934.

Wherefore, your petitioner prays that the decision and order of the United States Board of Tax Appeals heretofore entered against it on the 31st day of July, 1934, be reviewed and reversed by the Honorable Court of Appeals of the District of Columbia, and that your petitioner may have such other, further and general relief as to the Court in the premises may see- just and proper.

Dated, New York, N. Y., October 27, 1934.

RICHARD S. HOLMES,
Counsel for Petitioner.

52 STATE OF NEW YORK,
County of New York, ss:

Richard S. Holmes, being duly sworn, deposes and says that he is counsel for petitioner in the above entitled proceeding; that he has read the foregoing petition for review and knows the contents thereof; that the facts therein stated are true to the knowledge of deponent, except as to those matters therein stated to be alleged upon information and belief, and that as to those matters he believes it to be true.

RICHARD S. HOLMES.

Subscribed and sworn to before me this 29th day of October, 1934.

[NOTARIAL SEAL.] MICHAEL WEINTRAUB,
Notary Public.

New York County Clerk's No. 90. New York County Register's No. 6 W 256.

Term expires March 30, 1935.

53 [Stamp:] U. S. Board of Tax Appeals. Filed
March 14, 1935.

Docket No. 43,191.

GUANTANAMO SUGAR COMPANY, Petitioner,
against

THE COMMISSIONER OF INTERNAL REVENUE, Respondent.

Statement of Evidence.

Be it remembered, that the above entitled cause came on for hearing on the 20th day of April, 1933, before Honorable Annabel Matthews, Member of the United States Board of Tax Appeals, sitting as a Division of said Board, whereupon the following proceedings were had and evidence adduced by the respective parties and rulings made by the Board:

Whereupon to sustain the issues on its part joined petitioner called as a witness John Wollport who testified as follows:

My name is John Wollport, my occupation is Secretary-Treasurer of Guantanamo Sugar Company, which has its office at No. 129 Front Street, New York, N. Y.; the business of said Guantanamo Sugar Company is the manufacture of raw sugar and the operation of a railroad in connection with the manufacture and sale of its raw
54 sugar to refiners and other buyers all over the world.

As Secretary-Treasurer of Guantanamo Sugar Company I have custody of its books. Guantanamo Sugar Company was organized in the year 1905 under the laws of the State of New Jersey.

Whereupon a book was shown to the witness and the witness testified that it is one of the ledgers of petitioner; it is the only ledger in New York, and that which covers the period from 1905 to about 1909, and that the book was in his custody as Secretary-Treasurer. Thereupon the book shown to the witness was marked for identification as petitioner's exhibit No. 1 for identification. The witness thereupon continued his testimony as follows:

I have not in my custody the journal of Guantanamo Sugar Company covering the period covered by petitioner's exhibit No. 1 for identification; I have tried to locate it but

could not find it; I searched for it all over the office and all over the warehouse in Brooklyn; I think it might possibly have been placed in some of the material which was thrown away when the company was moving its office up and down town; the company moved its office up and down town at least ten times since I came with them and I have been with the company since 1914; the only explanation that I can give for the disappearance of the journal is that it may have been lost during the many moves which have been made of the company's offices. Turning to Petitioner's Exhibit No. 1 for identification, there is an account in that book showing the issue of the capital stock of Guantanamo Sugar Company. It is on page 1 and the name of the account is "Capital Stock."

Thereupon the book marked Petitioner's Exhibit No. 1 for identification was offered and received in evidence over the objection and exception of counsel for respondent that a proper foundation had not been laid by the witness, and that the witness had not properly explained why the original books of entry were not offered. The witness was then asked this question: "Will you turn to Petitioner's Exhibit No. 1 'Capital Stock' account, and state whether or not that account shows the acquisition of any shares of Guantanamo Railroad Company stock?" which question was objected to by counsel for respondent on the ground that the proper foundation had not been laid; said objection was overruled and an exception noted to respondent.

Thereupon the witness answered the question as follows:

A. "Yes, it mentions the Guantanamo Railroad Company being purchased, it refers to it by cost of property, or the amount of stock issued—purchase price four estates Los Canos, Soledad y Sabel y San Carlos, 5,630 shares."

At that point, counsel for respondent was granted the opportunity of testing the qualifications of the witness.

Thereupon the witness being questioned by counsel for respondent testified as follows:

I became connected with the taxpayer, Guantanamo Sugar Company, I believe in 1914. I am reading from records referring to 1905. Thereupon a motion was made by counsel for respondent to strike out all testimony given by this witness in regard to Petitioner's Exhibit No. 1 upon the ground that he was not qualified to testify and that proper foundation had not been laid, which objection

was overruled. Continuing, the witness testified: Mr. Henry F. Clark who acted as secretary for the company in the year 1905, died about 1922; he used to live in Yonkers. He was the first secretary; this book is in his handwriting; I know it well and I will swear to it; I am familiar with it.

Being questioned by the Member, the witness testified as follows:

I have been with the company since 1914; I joined the company then and I had charge of the books until 1926 when I was made an officer, secretary and treasurer, and have held that position ever since.

Counsel for respondent renewed his objection, and the objection was overruled and an exception to respondent noted. The witness then read from Petitioner's Exhibit No. 1 as follows:

"5,630 shares of the capital stock of the Guantanamo Railroad Company."

Continuing, the witness testified: There is some-
57 thing else in regard to that entry; it shows the amount of \$3,999,000. There is another entry made there on February 17, 1905, which I was about to read. This I am reading is of June 19, 1905. There is no allocation of the cost of Guantanamo Railroad Company stock as distinguished from the other assets which I read. There is an account in the ledger which shows the amount of cash paid. There is another account in this ledger and it is called the "Guantanamo Railroad Company Stock Investment" account which is upon page 212 of Petitioner's Exhibit No. 1.

Whereupon the following questions were asked of the witness: Q. "Is there in that account any entry showing the allocation of the cost of the Guantanamo Railroad Company shares, 5,630, I believe, which were referred to in that account; is there any other account?" This question was objected to by counsel for respondent and the objection was overruled and an exception to respondent noted. Continuing the witness testified:

The account says "Cost of property 5,630 shares, June 15, 1905, at \$75, \$422,250. 706 shares acquired by purchase September 30, 1905, to September 30, 1906, \$22,487, a total of \$444,737.02." On February 28, an entry was made showing the purchase of different shares of stock. They were as follows: 10 shares, \$34; 212 shares, \$35; 21 shares,

\$35, 2 shares, \$31; 25 shares, \$35; a total of \$9,432.

58 The figures given above are the prices per share of the stock purchased; on April 15, there were purchased 88 shares at \$35 per share, a total of \$3080. On May 1, 2 shares were purchased at \$35 a share, a total of \$70, making the total of all purchases to that time, \$457,-319.02. I think that that account represents the purchase of all the Guantanamo Railroad Company stock by petitioner because the account is closed.

Whereupon another book was shown to the witness who testified that said book was Ledger No. 2 of Guantanamo Sugar Company which covered the period from September 30, 1910, to June 30, 1915; that he has looked for a journal covering that period and looked everywhere possible and in the places in which he testified that he looked for the earlier journal; that the book shown to him was in his custody as Secretary-Treasurer of petitioner. Thereupon said book was offered and received in evidence over the objection and exception of counsel for respondent on the ground that the proper foundation had not been laid and sufficient explanation of the loss of the book of original entry has not been given. Said book was received in evidence as Petitioner's Exhibit No. 2.

Continuing, the witness testified: Turning to Petitioner's Exhibit No. 2, I do not think there is any account covering the Guantanamo Railroad Company stock. There is an account in which the stock was written down to \$1.00.

I do not believe there is any account showing any
59 further purchase of the Guantanamo Railroad Company stock. In answer to a question by the Member, the witness said that it was possible that if further stock had been bought, it may have been charged to Guantanamo Sugar Company directly. Continuing, the witness testified: In order to determine whether any account shows purchase of the stock of Guantanamo Railroad Company, I should have to look through the accounts running from pages 18 to 33, and maybe further. There are thousands of items, frequently as many as 100 items on a page. There is a surplus account in this ledger appearing on page 200. In that account, I find a reference to the stock of Guantanamo Railroad Company. I find the year and entry marked "Guantanamo Sugar Company" as per resolution of the Board of Directors, December 13, 1911, and the general manager's

recommendation of the Guantanamo Sugar Company (Cuba) items amounting to uncompleted betterments \$8,776.25; completed betterments, \$133,542.68. Guantanamo Railroad Company shares purchased, \$2,411.12, total \$144,730.05, or a total entry of accounts surplus amounting to \$913,017.30. This account does not show any entries specifically relating to Guantanamo Railroad Company's stock. Unfortunately, we do not have journal entry No. 181, which is tied up with this entry; there are three items here. I read off the entry of the surplus account "Guantanamo Sugar Company (Cuba) as per resolution of the Board of Directors of December 13, 1911, the general manager's recommendation" and I also read off the entry of the
60 amount charged to surplus of \$768,000 odd. That entry referred to a resolution of the Board of Directors, dated December 13, 1911.

Whereupon a book was shown to the witness entitled "Minutes of the Directors Meetings from December 14, 1910, to November 14, 1913, which the witness testified was the official minute book of the Board of Directors of Guantanamo Sugar Company, and that said book had been in his custody as Secretary-Treasurer of the company.

Thereupon the book shown to the witness was offered and received in evidence as Petitioner's Exhibit No. 3. Continuing, the witness testified: Turning to Petitioner's Exhibit No. 3, I find the minutes of a meeting of December 13, 1911, which contains a resolution directing a charge to surplus or write-down of assets; I find this resolution on page 340; there is a reference in that resolution to Guantanamo Railroad Company stock. The resolution reads as follows:

"Extract from minutes of regular annual meeting of board of directors of Guantanamo Sugar Company, held on Wednesday, December 13, 1911.

"The President then brought up the matter of the division of the \$768,287.25 written off cost of property and surplus for the year ending June 30, 1911, the Board having before them the division suggested by the vice-president and general manager.

"After a full discussion it was, on motion,

"Resolved, that the cost of the Guantanamo Railroad Company shares should be carried on the books at a nominal value of \$1.

“And it was

“Further resolved: That there should be written off the amounts set opposite the accounts as detailed in the following schedules, the total, including the railroad company shares, amounting to \$768,287.25:

61 “Agricultural buildings, \$196,144.26 to \$157,000. Reduction of \$39,114.26.

“Fences, \$43,532.59 to \$35,000. Reduction of \$8,532.59.

“Roads and bridges, \$51,641.64 to \$35,000. Reduction of \$16,641.64.

“Carts, \$24,659.27 to \$18,000. Reduction of \$6,659.27.

“Agricultural tools and implements, \$7,643.03 to \$5,000. Reduction of \$2,643.03.

“Steam plows, \$23,342.50 to \$20,000. Reduction of \$3,342.50.

“Batey buildings, \$131,181.87 to \$150,000. Reduction of \$26,181.87.

“Factory buildings—there was no change shown there.

“Railway roadbed, \$188,877.36 to \$120,000. Reduction of \$68,877.36.

“Factory machinery, \$1,177,459.48 to \$1,100,000. Reduction of \$77,459.48, making a total of \$249,452.

“Distillery, \$32,000 to \$20,000. Reduction of \$12,000. A total of \$261,452.

“Guantanamo Railroad Company shares, \$465,457.81.

“Lands, \$41,377.44, or a grand total of \$768,287.25.”

It was stipulated by counsel for the respective parties that petitioner would make no claim for the restoration to invested capital at the value of any of the assets written down in accordance with the foregoing resolution except the written down value of the Guantanamo Railroad Company stock.

Continuing the witness testified: I have read these minutes fully and these are the pertinent parts. The total was after the railroad shares were written off. The total of \$768,287.25 was written off as of December 30, 1911. I am sure that this resolution of December 13 has never been rescinded by the Board of Directors. The petitioner still owns the shares of stock of Guantanamo Railroad Company, and I have seen the stock. An objection was
62 made by counsel for respondent to this testimony on the ground that the proper foundation had not been laid, which objection was overruled and the exception

to respondent noted. The witness continued as follows: Petitioner still has the stock of Guantanamo Railroad Company. Guantanamo Railroad Company is a company which was at one time one of the most important railroads in Cuba. It ran from Guantanamo Bay at that time quite a distance; at the present time it runs from 85 to 100 miles. It is a standard gauge road with full equipment. It has trains for moving freight, and regular passenger trains; it takes passengers back and forth from the naval station, and it takes a great many passengers who go to intermediate points on the road. In addition to that, it also hauls all of the cane and the raw products of the Guantanamo Sugar Company, and all materials to a distance of 85 miles. It has the best shipping facilities on the Island of Cuba and the road is in excellent shape. I have been in Cuba on three different times to view the properties. I have travelled the entire length of this railroad. There are 10,000 shares of the stock of the Guantanamo Railroad Company outstanding and the petitioner owns about 8900. The vice-president and general manager of Guantanamo Sugar Company is president of the Guantanamo Railroad Company and the comptroller of the petitioner is the comptroller of Guantanamo Railroad Company. In fact all of the officers of Guantanamo Sugar Company are officers of Guantanamo Railroad Company. Guantanamo Railroad Company is operated exclusively in connection with petitioner's business; petitioner could not operate without it. There would be no way of moving its cane or its sugar. It would have to pay somebody else a prohibitive price. There is another railroad called the Guantanamo and Western Railroad in the neighborhood of petitioner's property. It is a longer railroad; it runs from the Port of Boceron to San Luis and then to the outskirts of Santiago. Guantanamo Railroad Company runs all the way through petitioner's property and neighboring properties. The railroad company has a number of tanks at Guantanamo which hold over four or five million barrels of molasses and some tanks that hold hundreds of thousands of barrels of oil. The railroad has loading and unloading facilities second to none in the Island of Cuba. The petitioner has loaned money to the Guantanamo Railroad Company. The books of the petitioner are kept on a fiscal year basis which is the fiscal year ending September 30, in each year.

Whereupon it was admitted by counsel for respondent that the amount which was written off as the cost of the stock of Guantanamo Railroad Company has never been restored to invested capital of petitioner in any of the returns filed by it to and including the fiscal year ending September 30, 1920. Continuing the witness testified:

64 Guantanamo Railroad Company is operating and it has been continuously operated ever since 1905. It was being operated during the years 1917, 1918, 1919 and 1920. Petitioner could not operate without it. The value of the stock of Guantanamo Railroad Company has been carried on the books of petitioner at \$1.00 ever since said stock was written off to that sum.

Upon cross-examination, the witness testified as follows: I testified that I went with the taxpayer in the year 1914 in the capacity of bookkeeper. I started with petitioner as bookkeeper and had charge of the export shipping, together with other duties in the office, but that was my principal duty. About 1916 or 1917 when the World War broke out, the sugar business expanded so rapidly that I had to give up the regular bookkeeping and take care of the export of materials to Cuba so that petitioner could operate the sugar mill. I was then more taken up with seeing that materials were bought in connection with the secretary of the company at that time, who was also the purchasing agent and in assisting in selling sugar. There was a lot of work to be done with the War Board and permits to be received from the Customs House and the War Trade Board in Washington. I did the general bookkeeping from the time I went with the company in 1914 or 1915 up until about 1917. Then I had a position a little higher than that where I had to do general work helping other people in the company.

Mr. Clark died in 1920 or 1921, and then Mr.
65 Bunker was made vice-president and general manager of petitioner and spent a lot of his time in Cuba and later spent half his time in Cuba and half his time in New York, and a lot of work that the secretary formerly did in New York was placed on my shoulders. In 1924, or 1925, I was made treasurer of the company and in 1926 Mr. McDougall, the secretary, left the company, and I was made Secretary-Treasurer. My position has always been in New York except when I made visits to Cuba. The bookkeeping

system in Cuba is quite a complicated affair. In the first place, the books are all kept in Spanish and I am not familiar with it; I cannot read Spanish; certain books are kept in Cuba; in fact the thing changes about from time to time. At the time when I came with the company the secondary accounts, that is the surplus account, the bills payable and bills receivable accounts were kept in New York, but the property account was kept in Cuba and then at the end of the year, after the profit and loss was made up, Price, Waterhouse & Company, the certified public accountants, would authorize the entries to be made charging or crediting the surplus account. Sometime later, all of the controlling accounts were brought up to the New York office. Mr. Sago was vice-president and general manager of the company at that time and he spent most of his time here then. He felt that he had spent enough time in Cuba and he wanted to spend more time in New York, and as a former comptroller he wanted the books in New York. In

1911, the book which had the capital account, the
66 bills payable and the bills receivable accounts of
Guantanamo Sugar Company, through which the
trial balance was prepared, was kept in New York. The
first entry in Petitioner's Exhibit No. 1 was not made by
me but was made in New York. Journal No. —, Page 89,
on February 28, 1907, may have been a subsidiary entry
from the original entry on the books in Cuba. I never
made the entry. I have nothing to hide; somebody else
made this entry. I did not. In January, 1911, I was not
with the company and I was not in Cuba in 1911. I do not
know of my own knowledge what was paid for the stock of
Guantanamo Railroad Company, and I did not see the
money transferred. I did not testify from my own knowl-
edge in regard to those facts, but I can read and the matter
has been gone into a great many times; the write-down of
the railroad stock to \$1.00 is not a subject which was
brought up today. Naturally, if I came with the company
in 1916, I would not know what they did in 1909. I know
that the books were properly kept. Unfortunately the
Secretary and Treasurer who made these entries has died.
Mr. McDougall who made this entry is living. Unfortu-
nately he has changed his position, but he is still living,
and he is the man who made the entry.

Whereupon a motion was made by counsel for respondent to strike out all of the testimony in regard to what occurred in 1911 as hearsay, which motion was denied and an exception noted to respondent.

Continuing, the witness testified: Guantanamo Railroad Company is a corporation separate from Guanta-
67 namo Sugar Company and is a Cuban corporation.

The petitioner controls all of the stock of the railroad company and had to loan it money. The books and the reports show that the Guantanamo Railroad Company owes petitioner about \$1,000,000; it has to borrow money in the idle season and repay in the active season, when the crops come in, when the railroad company carries molasses for the sugar company. I would say that in the idle season the railroad company was borrowing frequently from petitioner. I would say that from June until December the railroad company would borrow a certain amount of money from petitioner each month and when the crop came along in December until June, it would be credited for the amount of sugar which it hauled and that the entry would be offset in that manner. During the period that they were idle in each year, the railroad company was indebted to petitioner. The Guantanamo Railroad Company pays petitioner interest in its busy season which is credited as income on petitioner's books. There are two seasons, the busy season and idle season. The railroad company borrows money in the idle season and repays it in the busy season. Petitioner did not build this railroad; it was built long before petitioner was organized. It was taken over by petitioner. At one time it was the most profitable railroad in Cuba and that is why petitioner bought it. Later, it lost its relative position for the outside trade, but not so far as Guantanamo Sugar Company is concerned. I

68 do not know how the stock of Guantanamo Railroad Company was purchased. The property was purchased from Brooks Brothers, and I do not know what the actual consideration was.

Questioned by the Member, the witness testified: The business of the railroad company is the moving of molasses from one place to another on the railroad and its regular passenger service. It has four or five trains that go back and forth from the naval station bringing the officers over to the dock and then it has its regular passenger service;

it carries anywhere from 500 to 1,000 employees every day back and forth from the naval station.

Whereupon by order of the Member, the hearing in the above entitled cause was continued until April 29, 1933, at 9:30 o'clock in the forenoon. On that day by order of the Board, the hearing in the above entitled cause was continued until the 9th day of May, 1933, at Washington, D. C.

On the 9th day of May, 1933, pursuant to said order said cause came on for further hearings before Honorable Annabel Matthews, Member of the United States Board of Tax Appeals, at Washington, D. C., whereupon the following proceedings were had and testimony given: Mr. John Wollpert was recalled as a witness and he testified as follows: I have heretofore been sworn as a witness in this case. At the last hearing I testified that I was unable to find the journal of Guantanamo Sugar Company covering the period up to December 31, 1911; I have since
69 been able to locate it.

Whereupon a book designated "Minute Book No. 1" was shown to the witness who testified that that is the regular journal of Guantanamo Sugar Company; which book was in his custody as an officer of that company. Thereupon said book was offered and received in evidence without objection by counsel for respondent and was marked Petitioner's Exhibit No. 4.

Whereupon, another book was shown to the witness who testified that it was the original minutes of the meeting of the Board of Directors of Guantanamo Sugar Company and that it was in his custody as officer of that company, and that there are in said book the minutes of the first meeting of the Board of Directors which was held in the City of New York on February 17, 1905, and that the minutes are the original minutes and have not been rewritten.

Whereupon the book shown to the witness was offered and received in evidence without objection on the part of counsel for respondent, and was marked Petitioner's Exhibit No. 5.

The witness was not cross-examined.

Whereupon petitioner called as a witness Mr. Pedro Salazar who resides in Guantanamo, Cuba, and does not

70 speak the English language. Mr. Richard L. de Ruiz, an interpreter, was sworn as interpreter, and it was stipulated between counsel for the respective parties that the amount sought to be restored to the invested capital of petitioner for the taxable years in question for the written down value of the stock of Guantanamo Railroad Company should be limited to the sum of \$457,319.02.

Mr. Pedro Salazar then testified through the interpreter as follows:

My name is Pedro Salazar and I reside in Guantanamo, Cuba. I work for the Guantanamo Sugar Company, and I was auditor for the administration in Guantanamo; I know the Guantanamo Railroad Company and I worked for that company from 1902 to 1907, and then I continued as administrator until 1927. When I was employed by the Guantanamo Railroad Company, I kept the books and directed the work there on its books; I was the general auditor of the Guantanamo Railroad Company. I have not got the books of the Guantanamo Railroad Company for the year 1905 because in 1907 there was a fire and all of the books were burned up. The fire took place in the office and in the factory and everywhere. The locomotives were burned; the fire took place in Guantanamo.

During the year 1905, an audit was made of the books of the Guantanamo Railroad Company by Price, Waterhouse & Company and I assisted as auditor in making said audit; a formal report of the audit was made by Price-Waterhouse & Company.

Whereupon a document was shown to the witness who testified that that was the report made by Price-Waterhouse & Company, auditors, after they had gone over the books of Guantanamo Railroad Company and that the document is signed by Jones, Caesar, Wilmath & Company, the firm which made the audit; this firm is a firm of
71 certified public accountants in New York City and Price, Waterhouse & Company are the successors to or associated with them, and that firm is affiliated with Price, Waterhouse & Company; that he assisted in preparing the document; the figures in the document were taken from the books and the original books have all been destroyed by fire; that the figures in the document were correctly taken from the books.

Whereupon, the document shown to the witness was offered in evidence by counsel for petitioner, for the purpose

of showing the fair market value of the Guantanamo Railroad Company's stock at the time it was acquired by Guantanamo Sugar Company. Whereupon, counsel for respondent objected to the admission of said document in evidence, for the purpose of showing the fair market value of such stock, on the ground that the book value of its stock for the reason that a corporation for purposes of its own may write its assets up or down, and that, therefore, the book value of the assets is not reflected in the fair market value of its stock. After discussion, the following ruling was made:

"The Member: I will admit it for the purpose of showing the book figures of the stock, but I cannot in considering this case, I do not want you to think I am going to take it as representing the fair market value of the stock."

Thereupon the document shown to the witness and offered was received in evidence and marked Petitioner's Exhibit No. 6.

Continuing, the witness testified as follows: Turning to Petitioner's Exhibit No. 6, there is a balance sheet as of December 31, 1905. There is no reserve for depreciation set up on that balance sheet. I do not remember whether the books of Guantanamo Railroad Company show any depreciation account; I do not remember if depreciation
72 was taken or whether it was taken up in any way on the books; the method of charging for replacements may be explained by the report as to depreciation; I do not recall how this was done in 1905, but previous to that time, we used to take a 5% or 10% depreciation but in this year I have no specific recollection of it: not having the books in front of me, it is rather hard for me to answer these questions. I do not know for certain whether replacements were charged against current income but I used to take 5% or 8% for depreciation or something like that. There are no balance sheets for 1903 or 1904, still in existence. These balance sheets were made up by two members of the company but they were all lost in the fire. I was familiar with the assets of Guantanamo Railroad Company in the year 1905. On account of the nature of the work, I was well acquainted with the values thereof. The company had buildings and stations and 40 kilometers of rails and 5 locomotives and 8 passenger coaches and 80 or 90 freight cars. Then they had a repair shop and a yard for freight and passenger cars. They had one dock, which is located

at the end of the railroad, and an iron foundry. The railroad ran from Guantanamo to Caiminera, and from Guantanamo to the East to Jamaica and on the West it ran to Soledad—about 40 kilometers altogether.

Continuing, the witness testified: In 1905, there was no other railroad in the Guantanamo Valley and that there is one now—in 1907, this other railroad was started. The name of that railroad was the Guantanamo Eastern Railroad Company and it was later changed to the Guantanamo Western Railroad Company, and it was the same company. The Guantanamo Western Railroad Company has no connection whatever with the Guantanamo Railroad Company. It is a competing line and is in continuous competition.

73 Prior to my connection with the Guantanamo Railroad Company, I was engaged in the Custom House at Guantanamo. I was familiar with the estates taken over by the Guantanamo Sugar Company in 1905. These estates were owned by several people, one of whom was Brooks & Company; the estates known as San Carlos, Isabel, Soledad, Los Canos and San Vicente were owned by different people and were located in the vicinity of the Guantanamo Railroad Company's line. Prior to 1905, these estates, together with the estates known as San Antonio and San Miguel shipped their products over the Guantanamo Railroad Company's line, and in 1907, Guantanamo Eastern Railroad Company got most of the business. I mean that with the exception of the estates connected with Guantanamo Sugar Company, the other estates started to ship over the Guantanamo Eastern Railroad Company. Since 1905 the Guantanamo Railroad Company has been operated as an integral part of the Guantanamo Sugar Company. To some extent, the Guantanamo Railroad Company and Guantanamo Sugar Company are connected. Since 1905, the officers of Guantanamo Railroad Company were connected with Guantanamo Sugar Company—they did not hold the same office in each company but they held one office in one company and another in the other. Mr. Theodore Brooks was one of these officers. He held the office of vice-president and general manager of Guantanamo Sugar Company. The minute books of Guantanamo Railroad Company covering the period around 1905 are in existence.

Whereupon the witness was shown a book and testified that it was the minute book of the Guantanamo Railroad

74 Company covering the period from 1900 to 1928; that he kept the book from 1907 to 1926; that this book was in his possession as secretary of the Guantanamo Railroad Company.

Thereupon the book was offered and received in evidence over the objection and exception of counsel for the respondent that said book was not material to any of the issues of this cause. Said book was marked Petitioner's Exhibit No. 8, and exception was noted by the respondent.

Continuing, the witness testified: Turning to Petitioner's Exhibit No. 8, in order to get the earnings for 1900, I will have to look in the minutes of the meeting in January, 1901, which appear on pages 5 to 9 of said exhibit. The earnings of that year were \$60,767. The material portions of Petitioner's Exhibit No. 8 as translated by the interpreter for petitioner and the interpreter for respondent are as follows:

"In the City of Santiago, Cuba,
Jan. 31, 1901.

There assembled in the office of Brooks & Company in accordance with the advertisement in the newspapers of the locality and under the presidency of Don Luis Brooks, president of the Guantanamo Railway Company, the undersigned shareholders in conformity with the general regulations of the Company.

The Secretary read the act of the previous session which was approved, and also the statement of the administrator of the company covering the works executed on the line as well as rolling stock, buildings, shops, etc.

The Secretary presented the correspondence received during the year, and the accounts of proceeds and expenses and read the statement which is shown below. Proceeding, thereupon to name an examining committee in accordance with article 25 of the company's regulations, naming for this purpose:

75 Don Ernesto Despaigne, Don Adrian Grinan and Don Angel Luis Salazar who being present accepted the nomination.

Statement which shows the proceeds and expenses:

Gross Income	\$163,308.44
Collected from the Military Administration...	1,000.00
Profits and losses	11,575.76
	\$175,884.20
Less ordinary expenses for the year.....	115,117.20
	\$ 60,767.00

Which is segregated in the following manner:

Cash on hand	\$30.19	
Cash on deposit	55,822.01	
Various credits	4,914.80	
	\$60,767.00	\$ 60,767.00
From which sum there is deducted various credits	4,914.80	
		\$55,852.20
Plus interest from deposit with Brooks & Co.		862.20
		\$56,714.40
Hence the income of the year 1900 amounts to	\$46,355.28	
Plus that brought forward from the year 1899	10,359.12	
		\$56,714.40

Of which \$5,312.40 corresponds to the income of the shop; \$862.20 to interest leaving \$40,180.88 the net income of the line for the year 1900.

76 "The president proposed that these should be declared a dividend of five and a half per cent in U. S. currency, that is \$55,000.00 and that there should be distributed \$15,000.00 which is equivalent to one and a half per cent, there having been already distributed \$40,000.00 in July last as an advance made to the shareholders by the Board of Directors on account of dividends which were approved by the general board, and the shareholders present being in agreement with the proposition of the president, declared a dividend of five and a half per cent and approving the advance of four per cent made by the board in the month of July last."

“In the City of Santiago, Cuba,
January 31, 1902.

“There assembled in the office of Brooks & Company in accordance with the advertisement in the newspapers of the locality and under the presidency of Don Luis Brooks, president of the Guantanamo Railway Company, the undersigned shareholders in conformity with the general regulations of the Company.

“The Secretary read the act of the previous session which was approved, and also the statement of the administrator of the company covering the works executed on the line as well as rolling stock, buildings, shops, etc.

“The secretary presented the correspondence received during the year, and the accounts of proceeds and expenses and read the statement which is shown below. Proceeding, thereupon to name an examining committee in accordance with article 25 of the company's regulations, naming for this purpose:

Don Pascasio Diaz, Don Angel Luis Salazar and Don Adrian Grinan, who being present accepted the nomination.

“Statement which shows the proceeds and expenses:

“Proceeds:

Freight	\$158,349.91
Passengers	18,515.81
Shops	3,897.82

77

\$180,763.54

“Expenses:

Increase in equipment	\$4,913.18
Coal	13,751.08
A locomotive	11,965.70
30 prs. of wheels & Frame...	2,370.70
Gen'l expenses	16,493.38
Mechanical expenses	32,573.40
Maintenance & Repairs	36,937.39

156,882.97

Net income	23,880.57
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“The president stated that the board of directors agreed on the 13 day of July, 1901, to distribute a dividend of 5% as an advance to the shareholders for the reason that the

directors agreed that they already had a surplus greater than the quantity necessary for this distribution, leaving a prudent sum for the probable expenses up to December which was considered sufficient by the administrator of the company, but because of the cyclone which did so much damage in the province last September which caused the company considerable damage to which were added other expenses unforeseen, the amount left to meet ordinary expenses was not sufficient to cover those which this company found necessary to make for the indicated reasons and had to request the banker, Brooks & Company, to advance the necessary funds for expenses until the company could reimburse them with their products; and request the board of directors' approval of these operations. The board of directors approved unanimously that which had been done by the directorate and by the president.

“In the City of Santiago, Cuba,
January 29, 1903.

“There assembled in the office of Brooks & Company
* * * (omitting formal parts).

“Proceeds:

Shops	\$8,249.80
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78

Passengers	16,731.34
Freight	142,847.90
Interest	672.80

\$168,501.84

“Expenses:

Bridge, St. Vincente	300.00
Gen'l Expenses	18,152.91
Maint. & Repairs	35,454.87
Mechanical expenses	20,316.19
Transportation exp.	32,371.54
Combustibles	5,946.57
Supplies	8,766.82

121,308.90

47,192.94

Increase by the value of supplies	8,766.82
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Net proceeds	55,959.76
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Which sum is segregated as follows:

Deficit as of 12-31-1901.....	\$23,757.40	
Cash in banks.....	29,724.83	
Increase in Supplies.....	7,678.79	
		61,161.02

Less:

Decrease in supplies.....		5,201.26
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Net proceeds		55,959.76
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Of which \$8,249.86 belong to income of the shop;
79 and \$672.80 to interest, leaving \$47,037.16 as net proceeds of the line in the year 1902 as balance in favor of the company of \$29,724.83 at the 31st day of December, 1902.

“The president proposed that there should be distributed a dividend of 3% in American gold, that is \$30,000, taking the small sum which was lacking to complete this amount from the income already realized in the current month and the gentlemen present being of the same idea this was agreed upon.

“In the City of Santiago, Cuba,
January 30, 1904.

(Formal parts omitted.)

“Statement which shows the proceeds and expenses:

Proceeds:

Shops	\$5,319.45	
Passengers	23,752.13	
Freight	159,194.30	
Others	400.23	
Interest	640.75	
Reimbursements	969.72	
		\$190,276.58

Expenses:

General expenses	\$68,484.36	
Maint. & Repairs.....	44,114.50	
Mech. Traction	20,756.77	
Transportation	36,002.59	
Consumption of combustibles	9,080.48	
		178,438.70

Net proceeds		11,837.88
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Which sum is segregated as follows:

Proceeds of the year 1903, utilized
to complete the dividends dis-
tributed on account of income of
the year 1902.....

\$275.17

Cash on hand and in banks.....

1,036.69

Increase in supplies.....

13,636.78

14,948.64

Deduct:

Decrease in supplies.....

3,100.52

Pending obligations

10.24

3,110.76

Total equals 11,837.88

Of which \$640.75 belongs to interest credited to banking
houses, leaving a balance in favor of the company of
\$1,036.69 as of December 31, 1903.

“In the City of Santiago, Cuba,
January 30, 1905.

“(Omitting formal parts.)

“Statement which shows the proceeds and expenses:

Proceeds:

Shops \$4,898.53

Passengers 28,594.40

Freights 121,342.65

Others 345.07

\$155,180.65

Expenses:

Gen. Exp. \$43,213.72

Maint. & Repairs..... 30,226.17

Mechi. Traction 22,599.23

Transportation 37,774.67

Consumption of combustibles 10,262.73

144,076.52

Net proceeds 11,104.13

Of which \$4,898.53 corresponds to income of the shops and \$673.98 to interest on money on deposit, there remaining \$5,531.62 as net income of the line.”

“In the City of Santiago, Cuba,
January 27, 1906.

“Statement which shows the proceeds and expenses:

“Proceeds:

Shops	\$6,196.91	
Passengers	37,106.91	
Freight	141,032.22	
Warehouses	3,692.23	
Other proceeds	646.39	
		\$188,674.66

Expenses:

Gen. Exp.	22,778.58
Maint. & Repairs	33,225.82
Mech. Traction	27,154.94
Transportation	36,501.52

82

Consumption of combustibles	9,291.56	
		128,952.42

Net proceeds	59,722.24
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Of which there corresponds to income of the shops

Warehousing	6,196.91	
and to interest on deposits	3,692.23	
	89.71	
		9,978.85

Remaining as net income of the line \$49,743.39.”

Continuing, the witness testified as follows: The last dividend declared by Guantanamo Railroad Company was in January, 1903, but it was from the earnings of the year 1902; no dividend has been declared since that time. At the beginning of 1905, Guantanamo Railroad Company had a bonded indebtedness. The railway line of Guantanamo Railroad Company is a standard gauge line. Guantanamo Railroad Company has been operating continuously since 1905. In 1905, it began to build some spur tracks; these

were built on the estates of Isabel, Los Canos and San Carlos. The spurs belong to Guantanamo Railroad Company.

Upon cross-examination Mr. Joseph Weare was duly sworn as the interpreter for respondent, and the witness testified through said interpreter as follows: Guantanamo Sugar Company continued to advance money to Guantanamo Railroad Company after 1905. About a \$1,000,000 was advanced between 1905 and December, 1918. Upon re-

83 direct examination, the witness testified that the books of the Guantanamo Railroad Company are kept in American dollars.

The foregoing is a statement of evidence submitted to the Board of Tax Appeals in the above-mentioned case, so far as is necessary to the assignment of error as filed, reduced to narrative form.

RICHARD S. HOLMES,
Attorney for Petitioner.

(Sgd.)

ROBERT H. JACKSON,
Counsel for Respondent.

[Stamp:] Approved and ordered filed this 14 day of Mar., 1935. (Sgd.) Eugene Black, Member.

(Here follows Photos, side folios 84-87.)

88 [Stamp:] U. S. Board of Tax Appeals, Div. 13, Docket 43191. Petitioner's Exhibit 5. Admitted in Evidence May 9, 1933.

Guantanamo Sugar Company.

Minutes of Directors' Meetings.

89 Guantanamo Sugar Company.

Minutes of Directors' Meetings.

Minutes of meeting of Board of Directors of Guantanamo Sugar Company.

The first meeting of the Board of Directors of Guantanamo Sugar Company was held at the office of Masten & Nichols, No. 49 Wall Street, Borough of Manhattan, New York City, on the 17th day of February, 1905, at 3:15

Capital Stock.

1905 Sept 30	Balance	4000000 00	1905 Feb 17	By Cash received for the 10 Original Shares, issued to Incorporators and Directors one share each, as follows: William E. Glynn Victor Morawetz E. A. Brooks Chauncey M. Kingsland James H. Post Gerald L. Story Louis B. Diller Walter E. Hoyle E. Theodor Thygeson Forsyth Hicks	1000 00
			June 19	By Cost of Property Acquired of Stock issued being the Purchase Price for Estates "Los Laureles" Soldad "Epitafio" and Carlos and 5630 Shares of the Capital Stock of the Guantánamo R.R.	3999000 00
		4000000 00			4000000 00
1906 Sept 30	Balance	4000000 00	1905 Sept 30	Balance	4000000 00
1907 Sept 30	Balance	4000000 00	1906 Sept 30	Balance	4000000 00
1908 Sept 30	Balance	4000000 00	1907 Sept 30	Balance	4000000 00
			1908 Sept 30	Balance	4000000 00
				Carried Forward	2 4000000 00

Guantanamo Railroad Co Stock Investment Account

Feb 25	1907	To Cost of Property	444,737.02	1907	Sep 30	Balance	212	457,319.02
as of Sep 30/06		2630 shares acquired June 15/05 at the time of Purchase of Estates @ \$75 - \$422,250.00 706 shares acquired by purchase from Sept 30/06 to Sep 30/06 \$22,487.02 444,737.02						
Feb 28		To Cost of Property shares of RR stock from Sept 30/06 to date 6336 Oct 21/06 11 sh @ 34 \$370. Dec 19/06 212 " @ 35. 7420. Jan 4/07 21 " @ 35. 735. Jan 14/07 2 " @ 31 62. Jan 24/07 25 " @ 35. 875. \$9432	9432.00					
Apr 15		LTC 88 sh @ \$35 6.54	3080.00					
May 1		1116 " @ 35	70.00					
			457,319.02					457,319.02
1907				1905				
Sep 30		Balance	212 457,319.02	Feb 70		By Guantanamo Sugar Plant To transfer to Cuba book. by order of D.W.S. Accountant		457,319.02
			457,319.02					457,319.02

Surplus Account

1911	Dec	30	To 45% (Cuba)					1910	Sept	30	Balance from ledger #1	203	2290	759	81
			As per resolution of Board of Directors Dec 13/11 and Paul Morgan's recommendation	7/15/11	768	287	25		1911	June	30	By 45% (Cuba)	7/15	143	
1912	June	30	To 45% (Cuba)						1912	June	30	"			
			Uncompleted settlements 1776 25												
			Completed 133 541 68												
			MR Share Purchase 2411 12	7/25/11	144	730	05								
			144 730 05												
			Per Action of Directors and Accountants after closing of books at Guantanamo												
1912	June	30	Balance	200	170	778	00								
					26	208	05 30						26	208	05
1912	June	30	To 45% (Cuba)					1912	June	30	Balance	200	170	778	00
			Loss in operation year 1911/12	7/31/11	117	531	57								
			Retention		79	497	16								
			Adjustment of Repentance Fund		733	18	43								
			Balance	200	143	640	84								
					170	778	00						170	778	00
1912	June	30	Balance	200	156	657	684	1913	June	30	Balance	200	143	640	84
					156	657	684								
1915	June	30	To Stock Dividend	7/27/15	248	955	00	1915	June	30	Balance	200	156	657	684
			Cash Dividend		298	746	00								
			Dividends declared by Board of Directors on June 9, 1915 payable July 23, 1915 being stock dividend at the rate of 10% on the par value of Capital Stock outstanding, payable out of the Treasury Stock and Cash Dividend at the rate of 12%.												
			Brokerage & Commission	12/78	39	672									
			for account of Revenue Treasury												
			Income Tax for year ending June 30, 1915		105	5572									
			To raw sugar on hand	7/27/15	338	0216									
			& adjust monetary prices												
			To 45% (Cuba) & adjust		508	5118									
			By Value of Bonds												
			Balance	700	189	4733	25						25	380	4003
					153	804	003	1915	June	30	Balance to ledger #3	156	189	4733	25

o'clock in the afternoon, pursuant to a waiver of notice and consent signed by all the Directors of the corporation.

The following Directors were present: Walter E. Hope, Clarence McKenzie Lewis, Gerald L. Hoyt, James H. Post, Forsyth Wickes, constituting a majority of the entire Board of Directors.

Mr. Hope was elected temporary chairman and Mr. Wickes temporary secretary.

A consent to hold this meeting and a waiver of notice thereof, signed by every Director of the corporation, was presented by the secretary.

90 On Motion,

Resolved, that the original of such consent and waiver of notice be filed and preserved among the records of the corporation, and that there be incorporated in the minutes of this meeting a copy thereof, which is in the following form:

Guantanamo Sugar Company

Consent and Waiver of Notice of the First Meeting of Directors

We, the undersigned, being the entire Board of Directors elected by the incorporators of Guantanamo Sugar Company, a corporation organized under the laws of the State of New Jersey, do hereby waive notice of the time and place of the first meeting of the said Board of Directors and of the business to be presented at said meeting.

We hereby designate the 17th day of February, 1905, at 3:15 o'clock in the afternoon as the time, and the office of Masten & Nichols, No. 49 Wall Street, Borough of Manhattan, New York City, as the place of the first meeting of said Board of Directors; the purpose of said meeting being the adoption and approval of by-laws, the election of officers, the authorization of the issue of the stock of the said corporation, the authorization of the purchase of property necessary or proper for the business of the corporation and the transaction of such other business as may be necessary and advisable to complete the organization of said corporation and to facilitate the carrying on of its contemplated business.

And we do hereby waive all the requirements of the statutes of the State of New Jersey, both as to notice and the

publication thereof of the time, place and object of the meeting.

Dated New York, February 17th, 1905.

LOUIS B. DAILY,
CLARENCE McKENZIE LEWIS,
WALTER E. HOPE,
VICTOR MORAWETZ,
GERALD L. HOYT,
JAMES H. POST,
FORSYTH WICKES.

91 The Chairman presented to the meeting the resignation of Mr. Morawetz as a Director of the corporation.

On Motion,

Resolved, that the resignation of Mr. Morawetz be accepted and that the Board proceed to the election of a Director to serve for his unexpired term.

Mr. E. Theo. I. Thygeson was nominated for Director to serve for Mr. Morawetz' unexpired term and there were no other nominations.

A ballot was duly taken, and Mr. Thygeson was unanimously elected a Director to serve for Mr. Morawetz' unexpired term.

The minutes of the meeting of the incorporators were read.

The Chairman presented to the meeting by-laws for the regulation of the affairs of the corporation, which had been adopted by the incorporators in the form appearing of record in the minutes of the meeting of the incorporators held February 9th, 1905, and which were read section by section.

On Motion,

Resolved, that said by-laws as presented to the meeting be, and the same hereby are, in all respects approved and confirmed, and that the same be adopted as the by-laws of this corporation.

92 On Motion,

Resolved, that the Board proceed to the election of officers of the corporation to serve for one year and until their successors shall be chosen and qualified.

Mr. Walter E. Hope was nominated for election as the President of the corporation and there were no further nominations for that office.

A ballot was duly taken and Mr. Hope was unanimously elected the President of the corporation.

The President thereupon took the Chair.

Mr. James H. Post was nominated for election as Vice-President of the corporation and there were no other nominations for that office.

A ballot was duly taken and Mr. Post was unanimously elected Vice-President of the corporation.

Mr. E. Theo. I. Thygeson was nominated for election as Secretary and Treasurer of the corporation and there were no other nominations for that office.

A ballot was duly taken and Mr. Thygeson was unanimously elected Secretary and Treasurer of the corporation.

Mr. Thygeson thereupon took the oath of office as Secretary.

93 On Motion,

Resolved, that said oath of office taken by the Secretary be filed and preserved among the records of this corporation, and that there be incorporated in the minutes of this meeting a copy of said oath, which is in the following form:

Guantanamo Sugar Company.

STATE OF NEW YORK:

County of New York, ss:

E. Theo. I. Thygeson, the Secretary of the Guantanamo Sugar Company above named, being by me duly sworn, upon his oath deposes and says, that he will faithfully discharge the duties of Secretary of the aforesaid corporation to the best of his skill and ability.

E. THEO. I. THYGESON.

Sworn and subscribed to before me this 17th day of February, 1905.

WALTER E. HOPE,
Notary Public,

No. 223, Kings County. Certificate filed in New York County.

The Secretary presented to the meeting an impression of the corporate seal for the corporation, in the following form:

[Seal not legible in photostat copy.]

94 On Motion,

Resolved, that the seal thus presented, bearing the following words: "Guantanamo Sugar Company, Incorporated, New Jersey, 1905" be, and the same hereby is, approved and adopted as the corporate seal of the corporation.

The Secretary presented to the meeting a form of certificate of stock, in the following form:

(Here follows photolithographs folios 95 and 96.)

97 On Motion,

Resolved, that the form of certificate for stock thus presented be, and the same hereby is, in all respects approved and adopted as the certificate of stock of this corporation.

On Motion,

Resolved, that the Secretary be, and he hereby is, authorized and directed to procure all proper corporate books.

The Secretary then presented to the meeting instruments duly executed by the several subscribers to and the incorporators of the corporation assigning and transferring their several subscriptions to the capital stock as follows:

Forsyth Wickes, 1 share to William E. Glyn.

Forsyth Wickes, 1 share to Victor Morawetz.

Forsyth Wickes, 1 share to E. A. Brooks.

E. Theo. I. Thygeson, 1 share to Clarence McKenzie Lewis.

E. Theo. I. Thygeson, 1 share to James H. Post.

Walter E. Hope, 1 share to Gerald L. Hoyt.

Walter E. Hope, 1 share to Louis B. Dailey.

On Motion,

Resolved, that the originals of the said assignments be filed and preserved among the records of the corporation,



CAPITAL STOCK, \$4,000,000



QUINTANA ROO SUGAR COMPANY

INCORPORATED UNDER THE LAWS OF THE STATE OF NEW JERSEY

(This is to certify that _____ is the owner of _____ Shares of the Capital Stock of

QUINTANA ROO SUGAR COMPANY

transferrable only on the books of the Company by the holder hereof in person or by duly authorized Attorney upon surrender of this Certificate proper-ly endorsed.

Witness the Seal of the Company and the signatures of its duly authorized Officers affixed this _____ day of _____ 1900

PAID AND NON-ASSASSINATED

THE QUINTANA ROO SUGAR COMPANY

Treasurer

President



NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THE CERTIFICATE, IN EVERY PARTICULAR WITHOUT ALTERATION OR FILLING IN AT ANY CHANGE WHEREIN.

For value Received _____ hereby sell, assign and transfer unto

_____ the Shares of the Capital Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint _____ Attorney to transfer the said stock on the Books of the within named Company, with full power of substitution in the premises.

Dated _____ 190 _____

In Presence of _____

D9

98 and that there be incorporated in the minutes of this meeting a copy of one of said assignments (the others being identical in form) which is in the following form:

Assignment

The undersigned, for and in consideration of the sum of One Dollar to him in hand paid, has sold, assigned, transferred and set over, and by these presents does sell, assign, transfer and set over unto — — all his right, title and interest as a subscriber to Guantanamo Sugar Company, to the extent of — shares of the capital stock thereof, and hereby requests and directs the corporation to issue the certificate for said shares to the aforesaid transferee or his nominee and assigns.

Dated February —, 1905.

In Witness: — —.

On Motion,

Resolved, that an assessment of one hundred per cent be levied upon the shares of stock subscribed by the incorporators and partly assigned as aforesaid.

The Treasurer reported that one thousand dollars, the entire amount of capital stock subscribed under the certificate of incorporation, and the amount of capital stock with which this corporation is authorized by its certificate of incorporation to begin business, had been paid in in cash by the incorporators and their assignees, and that certificates of stock had been issued for the said payments.

99 On Motion,

Resolved, that the Treasurer be, and he hereby is, authorized to open a bank account in behalf of this corporation with Lawrence Turnure & Company, and in whatever other banks, trust companies or other depositories he may select, either in the United States or the Republic of Cuba.

On Motion,

Resolved, that in compliance with the laws of the State of New Jersey, this corporation have and continuously maintain a principal office and place of business within the State of New Jersey, and have an agent at all times in charge thereof and upon which agent process against

this corporation may be served, and therein keep the stock and transfer books for the inspection of all who are authorized to see the same and for the transfer of stock.

Resolved, that the books in which the transfers of stock shall be registered, and the books containing the names of the stockholders, shall be at all times during the usual hours of business open to examination as provided by law, at the principal office, and that the name of this corporation be at all times conspicuously exposed at the entrance of the said principal office in said State.

100 Resolved, that until this resolution be rescinded the office and place of business be in and at the office of the Corporation Trust Company, No. 15 Exchange Place, Jersey City, New Jersey, and that this corporation be registered with the said Trust Company.

Resolved, that the Corporation Trust Company be, and it hereby is, appointed the agent of this corporation for all of the aforesaid purposes, and the agent upon whom legal process against this corporation may be served in the State of New Jersey.

Resolved, that the Secretary be, and he hereby is, authorized to sign and seal with the corporation's seal a certificate of authorization to said Corporation Trust Company to the effect aforesaid, in such form as may be necessary to comply with the statutes of the State of New Jersey.

On Motion,

Resolved, that the principal office of the corporation in the State of New York be established and maintained at the office of Messrs. Lawrence Turnure & Company, No. 50 Wall Street, New York City, and that the regular meetings of the Board of Directors, until otherwise ordered, be in said office.

101 On Motion,

Resolved, that the Secretary of the corporation be, and he hereby is, authorized and directed on behalf of the corporation, and under its corporate seal or otherwise, to make and file certificates or other papers required by law to be filed in any State or Territory of the United States or in any foreign country in which the officers of this corporation shall find it necessary to file the same as a condition of transacting the business of the corporation in any such State, Territory or foreign country, and also

to make and file in any such State, Territory or foreign country a certificate showing the appointment and designation of an agent or attorney upon whom process against this corporation may be served, and who may administer the properties, business and affairs of the corporation in such State, Territory or foreign country.

Resolved, that the Secretary of the corporation be, and he hereby is, authorized and directed in behalf of the corporation and under its corporate seal to file the statement required to be filed in the office of the Secretary of State of the State of New Jersey, pursuant to Section 43 of the Corporation Law (Revision of 1896) of that State, and also thereafter to file any and all statements and certificates that may be required to be filed by any present or future law of that State.

The President submitted to the meeting a communication from Mr. McManus, of which the following is a true copy:

New York City, — — —.

To the Guantanamo Sugar Company.

GENTLEMEN:

I hereby offer to sell and to cause to be conveyed and transferred to your corporation, at the price and upon the terms hereinafter stated, the following mentioned sugar producing estates, situated near Guantanamo in the Island of Cuba, together with the shares of the capital stock, hereinafter mentioned, of the Guantanamo Railroad Company, viz:

(1) The estate "Soledad", situated at the northwestern terminus of the Guantanamo Railroad, three-quarters of a mile from the station of that name, consisting of a total of 7,832 acres in fee, and of rented estates aggregating 1,633 acres, together with all its appurtenances, comprising all buildings for the making and storing of sugar; railroad tracks some eight miles in length, with switches, sidings, bridges, locomotive house and rolling stock; also dwelling houses, stables, live stock, tools, implements and all usual appurtenances and fittings for plants of this description.

(2) The estate "Ysabel", situated at Jamaica, at the northeastern terminus of the Guantanamo Railroad consisting at present of 5,632 acres owned in fee and 300 acres

rented, together with the buildings, machinery and other appurtenances of the same general character above referred to.

(3) The estate "Los Caños", situated on the north shore of Guantanamo Bay, having a total area of 21,133 acres, together with like buildings, machinery, railroad, rolling stock, live stock and other usual appurtenances, including also wharves, boats, bridges, etc.

103 (4) The estate "San Carlos", situated about two miles northeast of Guantanamo, comprising over 15,000 acres of land with railroad, rolling stock, live stock, tools, etc., also the usual buildings and appurtenances.

(5) 5630 shares, being a majority, of the capital stock of the Guantanamo Railroad Company.

Particulars regarding the above properties are contained in the various detailed reports heretofore submitted for examination to the officers of your corporation.

The price and terms upon which I offer to sell the foregoing properties are as follows:

(a) You are to pay to me the sum of \$3,999,000, by issuing to me or to such person or persons as I may designate, 39,990 fully paid up shares of the capital stock of your corporation of the aggregate par value of \$3,999,000.

(b) The several estates above mentioned are to be sold and transferred to your corporation as going concerns with the standing crops of sugar cane and all cane that has been cut or that is in course of manufacture into sugar, together with all the manufactured sugar on hand at the time of transfer; but your corporation is to be bound to account to me for, and is to pay over to me, all cash and the proceeds of bills and accounts receivable that shall be transferred and delivered to your corporation with the said estates; all proceeds that may be realized by your corporation from sugar and other products manufactured prior to June 15, 1905, out of the sugar cane standing upon the said estates at the time of the transfer and conveyance thereof, or out of cane that has been cut, or out of sugar or other products wholly or partly manufactured, that shall be transferred and delivered to your corporation with such crates, after deducting from the foregoing sums the sum of \$300,000, which is to be retained by your corporation, and also all expenses of your corporation in operating and maintaining said estates and in carrying on the businesses transferred

to your corporation up to June 15, 1905. It is the intention hereof that your corporation shall be constituted the owner of the foregoing estates free from any charge or lien thereon, and on the 15th day of June, 1905, shall have, as working capital, the sum of \$300,000 out of the proceeds of the operation of the said estates up to June 15th, 1905, or out of cash or bills or accounts receivable transferred to your corporation; but that all sums in excess of \$300,000 received by your corporation with said estates or as net proceeds of the operation and maintenance thereof and the transaction of the businesses transferred to your corporation shall be paid over to me or to my assigns.

104 (c) In case I should fail to cause to be conveyed to your corporation prior to June 15th, 1905, any of the foregoing properties, then, at the option of your corporation, this agreement shall be terminated; but in case your corporation shall not elect to terminate this agreement, your corporation shall pay to me or to my assigns such portion of the aggregate price or consideration above mentioned in paragraphs (a) and (b) as shall bear to said aggregate price or consideration the same ratio as the value of the properties that shall have been conveyed and transferred shall bear to the aggregate value of all the properties hereinbefore described.

Awaiting your reply to this proposition, I am, gentlemen,
Yours very truly,

— — — .”

The President submitted to the meeting reports of experts on the properties described in the communication from Mr. McManus.

After a careful reading of said communication and a full discussion of the terms and provisions of the proposition therein contained and a thorough examination of the reports submitted, the following resolutions were unanimously adopted:

Whereas, the members of the Board of Directors of the corporation are familiar with the properties described in the communication from Mr. McManus and have
105 made careful investigation as to their market value;
and

Whereas, said properties are necessary and desirable for the business of this corporation, and this corporation has full power under its certificate of incorporation to pur-

chase the same and issue its stock in payment therefor; and

Whereas, this Board does hereby adjudge and determine and does hereby declare it to be its judgment and opinion that the proposition submitted to this Board by the said Mr. McManus is a fair, conservative and reasonable one, that it would be for the pecuniary and other advantage of this corporation to carry out the same, and that the properties proposed to be conveyed and transferred are intrinsically and actually worth the considerations asked therefor:

Resolved, that this corporation accept the proposition presented to the Board by Mr. McManus.

Resolved, that the President or Vice-President or the Secretary or Treasurer, or any other executive officer of this corporation or its local representatives in the Republic of Cuba, duly appointed by the Executive Committee of this Board, be, and they or either of them hereby are, authorized and directed, without further instruction or authority
106 from this Board, to execute and deliver in the name of this corporation and under its corporate seal, all such agreements or other instruments as may be requisite and necessary to carry out the true intent of the obligations entered into by this corporation by the acceptance of Mr. McManus' proposition and as may be advised and approved by counsel of the corporation.

Resolved, that upon the compliance of Mr. McManus with the terms of his proposition to the corporation thirty-nine thousand nine hundred and ninety shares of the corporation's stock, amounting in par value to \$3,999,000 be issued by the officers of the corporation in the manner provided in the by-laws, and delivered to Mr. McManus or his nominees.

The President submitted to the meeting a proposed power of attorney from the corporation to Claudio G. Mendoza and Ramon G. Mendoza and another to represent the corporation in the Republic of Cuba at the time of the transfer to the corporation of the properties agreed to be transferred by Mr. McManus, of which power of attorney the following is a true copy:

“Guantanamo Sugar Company.

Power of Attorney.

Know all men by these presents, that, whereas, the Guantanamo Sugar Company, a corporation duly organized according to the laws of the State of New Jersey, has purchased certain properties hereinafter referred to through Edward McManus, said Guantanamo Sugar Company has constituted and appointed, and by these presents does constitute and appoint Messrs. Claudio G. Mendoza, Ramon G. Mendoza and — — —, its lawful attorneys, jointly or severally, to represent the Company in the deeds to be executed by Messrs. Brooks & Company and other persons for the sale and transfer to the Guantanamo Sugar Company of said property, to wit, the estates “Soleidad”, “Los Caños”, “Ysabel”, “San Carlos”, and other real and personal property situated in the Province of Santiago in the Island of Cuba, the vendors to receive the price at the time of signing the deed or to acknowledge that they have received it previously from said McManus or from his attorney, the amount of which shall be established by said attorney who will also describe, in accordance with the vendors, the properties referred to, and establish all other clauses necessary and legal, in order that the acceptance of the deed of sale by the Guantanamo Sugar Company may be valid according to the laws in force in Cuba.

The Company furthermore authorizes said attorneys to accept the transfer of stock of the Guantanamo Railroad Company, now standing in the name of Messrs. Lawrence Turnure & Company, to be made to it by said firm, or by other persons signing for the purpose the necessary entries in the books of the Railroad Company or any other documents that may be rendered.

In witness whereof, the Guantanamo Sugar Company has caused these presents to be duly executed in its corporate name by its President thereunto duly authorized and its corporate seal to be hereunto affixed and attested by its Secretary this — day of February, 1905.

STATE OF NEW YORK,
County of New York, ss:

On February —, 1905, before me personally came — — —, to me known and known to me to be the President of

Guantanamo Sugar Company, who, being by me duly sworn, did depose and say that he resided in —; that he is the President of Guantanamo Sugar Company, the corporation described in and which executed the above instrument; that he knew the seal of said corporation; that the seal affixed to said instrument was such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

STATE OF NEW YORK,
County of New York, ss:

On February —, 1905, before me personally came — —, to me known and known to me to be the Secretary of Guantanamo Sugar Company, who, being by me duly sworn, did depose and say that he resided in —; that he is the Secretary of Guantanamo Sugar Company, the corporation described in and which executed the above instrument; that he knew the seal of said corporation; that the seal affixed to said instrument was such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

On Motion,

Resolved, that the President be, and he hereby is, authorized and directed to execute the aforesaid power of attorney in behalf of the corporation, and that the Secretary be, and he hereby is, authorized and directed to affix to said power of attorney the corporate seal.

Mr. Wickes thereupon tendered his resignation as Director.

109 On Motion,

Resolved, that the resignation of Mr. Wickes as Director be accepted.

On Motion,

Resolved, that the Board proceed to the election of a Director to serve for the unexpired term of Mr. Wickes.

Mr. William E. Glyn was nominated for Director to serve for the unexpired term of Mr. Wickes and there were no other nominations for this office.

A ballot was duly taken and Mr. Glyn was unanimously elected a Director to serve for the unexpired term of Mr. Wickes.

Mr. Hope thereupon tendered his resignation as President and Director and Mr. Thygeson tendered his resignation as Director.

On Motion,

Resolved, that the resignations of Mr. Hope as President and Director and of Mr. Thygeson as Director be accepted.

On Motion,

Resolved, that the Board proceed to the election of two Directors to serve for the unexpired terms of Messrs. Hope and Thygeson.

110 Mr. Victor Morawetz and Mr. E. A. Brooks were nominated for Directors to serve for the unexpired terms of Messrs. Hope and Thygeson respectively, and there were no other nominations for these offices.

A ballot was duly taken and Messrs. Morawetz and Brooks were unanimously elected Directors to serve for the unexpired terms of Messrs. Hope and Thygeson respectively.

On Motion,

Resolved, that the Board proceed to the election of a President to serve for the unexpired term of Mr. Hope.

Mr. William E. Glyn was nominated for President to serve for the unexpired term of Mr. Hope and there were no further nominations for this office.

A ballot was duly taken and Mr. Glyn was unanimously elected President to serve for the unexpired term of Mr. Hope.

On Motion,

Resolved, that the meeting adjourn.

E. THEO. I. THYGESON,

Secretary.

111 [Stamp:] U. S. Board of Tax Appeals. Div. 13.
Docket 43191. Admitted in evidence May 9, 1933.
Petitioner's Exhibit 6.

Guantanamo Railroad Company.

*Report, Balance Sheet and Profit and Loss Account. De-
cember 31st, 1905.*

112 Jones, Caesar, Dickinson, Wilmot & Co.

Certified Public Accountants, (Ill.)

Price, Waterhouse & Co.

Chartered Accountants.

54 William Street, New York.

June 30th, 1906.

The President, Guantanamo Railroad Company, Guan-
tanamo, Cuba.

DEAR SIR:

Guantanamo Railroad Company.

As instructed by you we have audited the books and ac-
counts of the Guantanamo Railroad Company for the year
ending December 31st, 1905, and now beg to hand you here-
with—

Balance Sheet, December 31st, 1905.

Income Account, year ending December 31st, 1905.

Detail of Operating Expenses, year ending December
31st, 1905.

We have the following remarks to make on the accounts:

Balance Sheet.

Assets.

Cost of Road—\$984,607.06:

Ledgers were produced dating back to 1856, the time at
which the Company was formed, and these ledgers have
been carefully examined for items making up the above
amount.

The principal charge to this account was made at Febru-
ary 28th, 1882 when the capital of the Company was in-

creased from \$400,000.00 to \$1,000,000.00, the difference of \$600,000.00 being charged to Cost of Road and credited to Capital Account.

We have looked through the Operating Accounts for items charged thereto which might properly have been charged to Cost of Road, and find that between 1881 and 1885 there was charged to these accounts for extension of Main Line and the Jamaica and Soledad Branches, etc., about \$371,000.00.

113 These were the only items which we could readily ascertain as having been so charged, and we did not think it advisable to go more deeply into the matter, as, owing to the lapse of time and difficulty in getting vouchers, any further investigation would have been a matter of considerable difficulty.

We would suggest that a valuation of the Road and other Capital Assets should be made and the book values brought into accord with same.

The length of the Road as reported by the General Manager is as follows:

Main Line	44.195	Kilometers
Branch Lines	3.373	"
"Y"s	1.118	"
Sidings	5.770	"
	54.456	"

Extensions of Line—\$162,331.59:

This represents expenditure in 1905 for the La Maya Extension and also extension from Jamaica to Ysabel. The greater part of these charges are for grading, bridge work, track-laying, rails, ties and material for bridges.

The figures as presented by the Manager have been adjusted so as to include charges of \$15,803.42, for 1905 items paid for in January 1906 but not on the books at December 31st, 1905; for \$1,837.60, an amount charged to General Expenses on account of surveys; for credits of \$18,271.93 on account of lines built for Soledad and Ysabel, the items of which had been charged to this account; and for deposits amounting to \$5,090.00. This sum includes deposits made as a guarantee that the line would be built, as well as some small ones in judicial proceedings in connection with Right of Way. The deposits are not properly chargeable to this account.

Buildings—\$75,027.94:

This account was opened in 1902 by a transfer to it from Cost of Road of.....		\$17,000.00
Since that date there have been added, according to the books:		
In 1904—house bought by the Railroad for Custom House		2,500.00
Carried forward		\$19,500.00
114	Brought forward	\$19,500.00
	Paid for building pier at Deseo.....	22,102.65
	Paid for building storehouse at Deseo.....	25,179.23
	And in 1905 sundry other items amounting to..	8,246.06
		\$75,027.94

The 1905 items were vouched so far as possible, but not so as to identify them with this account; it was thought to be sufficient to simply see that the money had been accounted for. The time taken to trace the items to this account would not have lessened the necessity for an appraisal.

Rolling Stock—\$224,925.35:

Beginning in 1863 an account called "Cost of Road" was opened to which all Capital Expenditure was charged. This was continued until 1897 when the account was split up into Rolling Stock, Lands, Tools and Supplies, etc. It is, however, impossible to check this distribution. The charge to Rolling Stock at this date was \$141,731.16. The difference represents additional expenditure since that date.

In view of the fact that the last war in Cuba, not to mention the two prior ones, used up most of the Rolling Stock of the Company, it is believed that the book value is in excess of the value of the equipment now on hand.

An adjustment has been made charging this account with \$36,425.38 for Rolling Stock paid for in 1906 but delivered in 1905 and not on the books at December 31st 1905.

A credit has been made to this account of \$2,016.05 for old parts of dismantled equipment used during the year in work done for outsiders.

The equipment at December 31st as reported by the Manager was as follows:

Rolling Stock on December 31st, 1905:

	4 Passenger and Freight Locomotives.
	1 Switching Locomotive.
	1 Inspection Locomotive.
	7 Passenger Coaches.
	38 Box Cars.
115	46 Flat Cars.
	37 Cane Cars.
	7 Tank Cars.
	3 Baggage Cars.

Lands—\$9860.24:

There was charged to this account in 1897, when the Cost of Road Account was distributed over various assets, the sum of \$11,360.24.

In 1897 a credit of \$1,500.00 to the account appears for twenty-seven and three-tenths caballarias sold to Messrs. Brooks & Company in May of that year, leaving a balance on the books of the present figure.

Furniture—\$2,135.75:

This account was opened by a charge of \$2,012.25 in 1897 on the distribution of the Cost of Road Account.

The charges since consist of expenditures for chairs, desks, etc.

Tools and Supplies—\$84,247.73:

This account was opened in 1897 on the distribution of Cost of Road Account with a charge of \$55,832.70.

No inventory has ever been taken of the Tools and Supplies, and it is believed that the book figure is largely in excess of the actual value of the Tools and Supplies now on hand.

Capital Stock in Treasury—\$1,100.00:

On examining the Stock Ledger kept by the Secretary at Santiago it was found that eleven shares were still in the treasury. These arose from the fact that when the increase of capital from \$400,000.00 to \$1,000,000.00 was made no half shares were issued and the eleven shares unissued represent the accumulation of these half shares. No record of these shares appears on the books of the Company and we

have set same up as an asset, crediting Cost of Road Account which was charged with the full \$600,000.00 at the time of the increase.

Interest Paid in Advance—\$11,657.77:

This represents the Interest paid in Advance at December 31st 1905 on the loans amounting to \$186,000.00 from the Guantanamo Sugar Company.

116 The Company had set up as a liability only the proceeds of the notes from the Guantanamo Sugar Company and had not charged any Interest against the Income Account of the year. We have, however, shown a liability for the face value of the notes and an asset for the Interest paid in Advance.

Fuel:

Coal—\$6,572.08;

Wood—\$33.31:

These are merely book figures, but the General Manager is of opinion that the Coal and Wood on Hand at December 31st 1905 approximated the amounts.

Deposits with Cuban Government—\$15,341.00:

These amounts were deposited with the Cuban Government as a guarantee that certain extensions, etc. would be carried out, and will be returned on completion of the work. The amounts had been charged to Extensions, etc. by the Company, but have been transferred by us.

Accounts Receivable—\$44,455.78:

The custom of the Company has been to run the accounts on a cash basis and not to carry Accounts Payable or Accounts Receivable on the books except occasionally at the end of the fiscal year. Of the amount shown on the Balance Sheet \$42,985.36 represents adjustments made by us of items belonging to 1905 but not taken on the books until 1906, the principal items being an amount due by the Guantanamo Sugar Company for tracks in Soledad Batey and in Ysabel Batey built by the Railroad for the Sugar Company, and an item of \$18,804.24 being second and final instalment of an amount owing by the Spanish Government

for transportation and services rendered during the war which began in 1868.

Liabilities

Capital Stock—\$1,000,000.00:

The original capital issued in 1856 was	\$350,000.00
This was increased in 1858 by	50,000.00
and in 1882, as already mentioned, a Stock dividend was paid of	600,000.00
making a total capital of	\$1,000,000.00

117 As already explained eleven shares still remain in the Treasury.

Guantanamo Sugar Company Loan Account—\$186,000.00:

The Company showed on their books an amount of \$171,120.00, being the proceeds of notes for \$186,000.00 discounted by them. As already explained, we have set up the full liability.

Accounts Payable—\$54,060.01:

Of this amount \$53,865.25 represents liabilities applicable to the year 1905 not brought into the books by the Company until 1906. The principal items making up this amount consist of an amount owing for rolling stock of \$36,425.38 and for bridge, material, ties, etc. of \$15,803.42.

Cash Overdraft—\$2,747.26:

The Company have been in the habit of keeping the Cash Book open after December 31st and treating as cash at December 31st any receipts and payments applicable to the previous year. This amount consequently does not represent the actual cash balance at December 31st and we were unable to ascertain from the Cash Book the exact date at which the cash should have been closed. The only effect of this would be to increase or decrease the Accounts Receivable and Accounts Payable.

The overdraft due to the Bank was verified from the books of Messrs. Brooks & Company and the Cash on Hand was counted during the course of our examination.

Surplus at January 1st 1905—\$320,568.62:

We have added to the balance shown by the books at January 1st 1905 the amount of \$18,804.24 due by the Spanish Government, already referred to, and also an amount of \$10,251.00 being deposits in 1893 with the Cuban government as guarantee that the La Maya extension would be built, and which we have set up as an asset.

Income Account.

Freight—\$141,291.54:

A summary was drawn off the Freight Books and compared with the amount on the ledger and found to be within \$125.00 of agreement.

118 A considerable number of the Freight bills were checked to the books and the calculations were tested and compared with the tariff.

According to Cuban law the original bills of lading should be returned by the shipper in exchange for his goods and this should be compared with and attached to the triplicate which has been sent to the office. About eighty-five of these are missing in the period which was examined. This is explained by the fact that the bills of lading were for goods going through to Santiago, for which the shippers secured another bill of lading from Messrs. Brooks & Company upon exhibiting the bill of lading from the Railroad. This made the Railroad bill of lading superfluous, but at that time it was not collected by Messrs. Brooks & Company and returned to the Company as is done at present.

Passenger—\$37,256.91:

The income from passengers during the year has been worked out from the record of tickets sold, and comes very close to the ledger figure. It would therefore appear that all sales reported have been accounted for.

Storage—\$3,692.23:

This was carefully worked out to see if the Company received all the storage to which it was entitled and is believed to be correct.

Profit on Machine Shop Work—\$2,681.10:

The Company in the Statement of Earnings prepared by them showed only the gross receipts for work done by the

G U A N T A N A M O R A I L R O A D C O M P A N Y

B A L A N C E S H E E T DECEMBER 31st 1905

<u>Assets</u>			<u>Liabilities</u>		
<u>CAPITAL ASSETS:</u>			<u>CAPITAL STOCK</u>		\$1,000,000.00
Cost of Road	\$ 984,607.06		<u>CURRENT LIABILITIES:</u>		
Extensions	162,331.59		Guantanamo Sugar Company Loan Account	\$ 186,000.00	
Buildings	75,027.94		Accounts Payable	54,060.01	
Rolling Stock	224,925.35		Cash - Bank Overdraft less		
Lands	9,860.24		Cash in hand	<u>2,747.26</u>	242,807.27
Furniture	2,135.75				
Tools and Supplies	<u>84,247.73</u>	\$1,543,135.66			
<u>CAPITAL STOCK IN TREASURY:</u>					
11 Shares at par		1,100.00	<u>SURPLUS:</u>		
<u>DEFERRED CHARGES TO INCOME:</u>			As at January 1st 1905	\$ 320,568.62	
Interest paid in advance		11,657.77	Add - Net Income for year ending		
			December 31st 1905, per		
			Income Account annexed	<u>58,919.71</u>	379,488.33
<u>CURRENT ASSETS:</u>					
Coal	\$ 6,572.08				
Wood	33.31				
Deposits with Cuban Government	15,341.00				
Accounts Receivable	<u>44,455.78</u>	66,402.17			
		<u>\$1,622,295.60</u>			<u>\$1,622,295.60</u>

G U A N T A N A M O R A I L R O A D C O M P A N Y

I N C O M E A C C O U N T

YEAR ENDING DECEMBER 31st 1905

	<u>% of Gross Earnings</u>	
<u>OPERATING EXPENSES:</u>		
Maintenance of Way and Structures	17.99	\$ 33,376.54
Maintenance of Equipment	10.95	20,318.30
Conducting Transportation	28.09	52,126.90
General Expenses	8.84	16,407.87
	65.87	\$122,229.63
<u>TAXES</u>	.43	797.70
<u>NET EARNINGS CARRIED DOWN</u>	33.70	62,540.84
	<u>100.00</u>	<u>\$185,568.17</u>
<u>INTEREST ON LOANS</u>		\$ 3,621.13
<u>NET INCOME FOR YEAR, carried to Balance Sheet</u>		58,919.71
		<u>\$ 62,540.84</u>

	<u>% of Gross Earnings</u>	
<u>GROSS EARNINGS:</u>		
Freight	76.14	\$141,291.54
Passenger	20.07	37,256.91
Storage	1.99	3,692.23
Profit on Machine Shop Work for outsiders	1.45	2,681.10
Miscellaneous	.35	646.39
		\$185,568.17
	<u>100.00</u>	<u>\$185,568.17</u>
<u>NET EARNINGS brought down</u>		\$ 62,540.84
		<u>\$ 62,540.84</u>

Machine Shop, but we have endeavored to charge against this account all material and labor used on work for outsiders in order to show whether this department was being operated at a profit.

Operating Expenses—\$122,229.63:

We have endeavored to classify the expenses in accordance with the classification adopted in the United States. We have, however, accepted the various sub-divisions shown by the Company and have simply endeavored to arrange these as closely as possible after the Interstate Commerce classification.

Details of the expenses will be found in the exhibits.

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General

The vouchers for all payments were checked as far as possible, and while receipts were not obtained in all instances we have endeavored to satisfy ourselves that all the payments during the year were properly made.

The books have been kept on a cash basis, but we have devised a System of Accounting upon which we are reporting separately and which should ensure that in future the books will be kept in accordance with modern accounting methods.

As mentioned throughout the report, we have made several adjustments on the accounts as prepared by the Company, but we do not think it would be advisable for them to be made on the books as most of the entries have since been passed through the books and as an accurate Balance Sheet should be prepared when the New System goes into force, we think it would be better to wait until that date, and at that time have a proper Balance Sheet prepared.

We have checked the journalizing of the Cash Book and the footings and postings of the Journal. The Pay Rolls for the month of July were also checked with the Foremen's daily reports and the extensions and footings of the Pay Rolls checked for the same month.

We shall be glad to furnish you with any information which you may desire regarding the accounts.

Yours very truly,

JONES, CAESAR, DICKINSON, WILMOT
& CO.

(Here follows photolithographs, folios 120 and 121)

122 Guantanamo Railroad Company.

Detail of Operating Expenses.

Year Ending December 31st, 1905.

Maintenance of Way and Structures.

Roadway	\$18,435.59
Cutting Grass—Roadway	2,251.74
Bridges	2,724.66
Culverts	312.78
Fences	3,261.19
Crossing-Keepers, Watchmen, etc.	3,367.00
Stations	1,337.25
Employes' Houses	411.11
Telegraph	693.50
Miscellaneous, less credits	581.72
	\$33,376.54

Maintenance of Equipment.

Superintendence	\$2,600.00
Mechanics	2,260.38
Boiler-Makers	1,111.80
Foundrymen	1,489.94
Blacksmiths	1,973.37
Firemen	366.75
Pattern-Makers	720.40
Carpenters	4,562.08
	\$15,084.72
Less—Chargeable to work for out- siders and miscellaneous credits	3,135.40
	\$11,949.32
Fuel	1,370.40
Material for Locomotives	5,530.31
Material for Repair of Cars	1,468.27
	\$20,318.30

123 Conducting Transportation.

Engineers and Firemen	\$ 7,723.46
Oilers and Repairmen of Cars...	942.65
Fuel for Locomotives	7,553.77
Grease	1,506.39
Waste	401.67
Transportation Materials	2,612.67
Conductors and Brakemen.....	5,487.81
Loading and Discharging	2,563.48
Switchmen	708.41
Station Agents	11,515.82
Station Laborers	6,924.15
Station Supplies	1,922.40
Damage Claims	2,247.70
Subscriptions and Advertising...	201.57

\$52,311.95

Less — Miscellaneous credits less
adjustments

185.03

\$52,126.92

General Expenses.

Salaries	\$9,543.53
Pensions	612.00
Rents	2,336.10
Postage and Telegrams	170.53
Telephone	96.00
Supplies for Office	658.37
Printing	201.71
Legal Expenses	1,376.33
Railroad Commission	371.11
Insurance	700.00
Miscellaneous	2,032.74

\$18,098.42

Less—Miscellaneous credits

1,690.55

\$16,407.87

124 [Stamp:] United States Board of Tax Appeals.
Filed Mar. 13, 1935.

United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Præcipe for Record.

Filed March 13, 1935.

To the Clerk of the United States Board of Tax Appeals:

You are hereby requested to prepare and certify and transmit to the Clerk of the Circuit Court of Appeals for the Second Circuit, with reference to petition for review heretofore filed by the petitioner in the above cause, a transcript of the record in the above cause, prepared and transmitted as required by law and by the rules of said Court, and to include in said transcript of record the following documents or certified copies thereof, to wit:

(1) The docket entries of all proceedings before the Board of Tax Appeals.

(2) Pleadings before the Board of Tax Appeals, as follows: (a) Petition for Redetermination. (b) Answer of the respondent. (c) Amendment to petition. (d) Answer to petition as amended.

(3) Opinion of the Board of Tax Appeals.

125 (4) The decision of the Board.

(5) The petition for review, filed by the petitioner in the above cause.

(6) The statement of evidence as agreed upon with the following exhibits: Exhibit 1—Capital stock account and ledger pages 1 and 212. Exhibit 2—Page 206 of Ledger #2. Exhibit 4—Page 181 of surplus account. Exhibit 5—Pages 1 to 20 inclusive of Minute Book #1. Exhibit 6—Report of Price, Waterhouse.

(7) This præcipe.

RICHARD S. HOLMES,
Attorney for Petitioner.

Service of a copy of the foregoing is hereby acknowledged this 13th day of March, 1935.

ROBERT H. JACKSON,
*Assistant General Counsel
for the Bureau of Internal Revenue,
Attorney for Respondent.*

126 United States Board of Tax Appeals, Washington.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,
v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Certificate.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 125, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Præcipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 9th day of April, 1935.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

127 United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,
v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Order Enlarging Time.

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record *sur* petition

for review of the above entitled proceeding by the U. S. Court of Appeals of the District of Columbia be and hereby is extended to January 28, 1935.

(Signed)

EUGENE BLACK,
Member.

Dated Washington, D. C., December 27, 1934.

evw.

Now, April 9, 1935, the foregoing order enlarging time certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

128 United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Order Enlarging Time.

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record *sur* petition for review of the above entitled proceeding in the United States Court of Appeals for the District of Columbia, be and it is hereby extended to Feb. 18, 1935.

(Signed)

EUGENE BLACK,
Member.

Dated Washington, D. C., Jan. 28, 1935.

jd.

Now, April 9, 1935, the foregoing order enlarging time certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

129 United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Order Enlarging Time.

On motion of counsel for the respondent, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record *sur* petition for review of the above entitled proceeding in the United States Court of Appeals for the District of Columbia, be and it is hereby extended to March 5, 1935.

(Signed)

EUGENE BLACK,

Member.

Dated Washington, D. C., Feb. 14, 1935.

jd.

Now, April 9, 1935, the foregoing order enlarging time certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,

Clerk, U. S. Board of Tax Appeals.

130 United States Board of Tax Appeals.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Order Enlarging Time.

On motion of counsel for the petitioner and consent of counsel for the respondent, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record *sur* petition for review of the above entitled proceeding in the United States Court of Appeals for the District of Columbia, be and it is hereby extended to March 15, 1935.

(Signed)

EUGENE BLACK,

Member.

Dated Washington, D. C., March 5, 1935.

jd.

Now, April 9, 1935, the foregoing order enlarging time certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

131 United States Board of Tax Appeals, Washington.

Docket No. 43191.

GUANTANAMO SUGAR COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Order Enlarging Time.

For cause appearing of record, it is

Ordered that the time for transmission and delivery of the record *sur* petition for review of the above entitled proceeding in the United States Court of Appeals for the District of Columbia be and it is hereby extended to April 15, 1935.

(Signed)

EUGENE BLACK,
Member.

Dated Washington, D. C., March 15, 1935.

evw.

Now, April 9, 1935, the foregoing order enlarging time certified from the record as a true copy.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Endorsed on cover: Board of Tax Appeals. No. 6458. Guantanamo Sugar Company, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. United States Court of Appeals for the District of Columbia. Filed Apr. 11, 1935. Henry W. Hodges, Clerk.

UNITED STATES
COURT OF APPEALS FOR THE
DISTRICT OF COLUMBIA

FILED FEB 15 1936

Henry H. Hodges

CLERK

IN THE
United States Court of Appeals
OF THE DISTRICT OF COLUMBIA

APRIL TERM, 1935.

No. 6458.

GUANTANAMO SUGAR Co.,
Petitioner

v.

GUY T. HELVERING,
COMMISSIONER OF INTERNAL REVENUE.

BRIEF FOR THE PETITIONER.

DAVID A. BUCKLEY, JR.,
Counsel for Petitioner.

RICHARD S. HOLMES,
LORING M. BLACK,
HARVEY L. RABBITT,
Of Counsel.

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IN THE
United States Court of Appeals
OF THE DISTRICT OF COLUMBIA

APRIL TERM, 1935.

No. 6458.

GUANTANAMO SUGAR Co.,
Petitioner

v.

GUY T. HELVERING,
COMMISSIONER OF INTERNAL REVENUE.

BRIEF FOR THE PETITIONER.

OPINION BELOW.

The memorandum opinion of the United States Board of Tax Appeals was rendered on the 31st day of July, 1934, and was not published or reported in the United States Board of Tax Appeals reports. It is found on pages 27 to 31, inclusive of the record.

JURISDICTION.

The memorandum decision of the United States Board of Tax Appeals was entered on July 31st, 1934 (R. 32), and the petition for review by the Court filed October 30, 1934, together with an agreement under Section 1002 (d) of the Revenue Act of 1926, as amended by Section 519 of the Revenue Act of 1934, providing the venue for review to be in this Court (R. 32).

The jurisdiction of this Court is invoked under Section 1001, Revenue Act of 1926.

QUESTIONS PRESENTED.

1. Whether petitioner is entitled to have restored to its invested capital for the fiscal years ended September 30, 1918, and September 30, 1920, the actual cash value of 5,630 shares of the capital stock of the Guantanamo Railroad Company, paid in to petitioner at the time of its organization, for shares of its stock and owned by petitioner during said fiscal years, which shares were included in assets written down on petitioner's books to the value of \$1.00 on the 30th day of December, 1911, the actual cash value of which had not been restored to surplus, and its income, excess and war profits taxes for these years recomputed on that basis?

2. What was the actual cash value of said 5,630 shares of stock of the Guantanamo Railroad Company at the time same were acquired by petitioner, in exchange for shares of its stock?

3. Whether petitioner is entitled to have restored to its invested capital for the fiscal years ending September 30, 1918, and September 30, 1920, the sum of

\$35,069.02 the actual cost to petitioner, of 1,066 shares of the stock of the Guantanamo Railroad Company purchased by petitioner for cash between September 30, 1905, and February 20, 1908, and owned by petitioner during said fiscal years, which shares were included in the assets written off to the sum of \$1.00 on the books of petitioner as of December 30, 1911, and the cost of which has never been restored to surplus, and its income, excess and war profits for these years recomputed on that basis.

STATUTES INVOLVED.

Section 325 (a) of the Revenue Act of 1918 provides in part as follows:

“Sec. 325 (a) That as used in this title.—The terms ‘tangible property’ means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property.”

Section 326 (a) of the Revenue Act of 1918 provides in part as follows:

“Sec. 326 (a) That as used in this title the term ‘invested capital’ for any year means (except as provided in subdivisions (b) and (c) of this section):

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus.”

Article 842 of Regulations 45 issued under the Revenue Act of 1918 provides as follows:

“Art. 842. Surplus and undivided profits: property paid in and subsequently written off.—Where tangible or intangible property has been paid in to a corporation for stock or shares or as paid-in surplus, and has subsequently been in whole or, in part written off the books, the amount as written off may upon evidence satisfactory to the Commissioner be restored to the capital or surplus account subject to the following limitations:

(1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence, or depletion; and

(2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.”

STATEMENT.

The Guantanamo Sugar Company is a corporation, organized in the year 1905 under the laws of the State of New Jersey, with its principal office and place of business at No. 129 Front Street in the city of New York, State of New York (R. 39). It is engaged in the business of producing and selling raw sugar and owns and operates a number of sugar estates in Cuba. The Guantanamo Railroad Company is a Cuban Corporation and the petitioner has operated it as an integral part of its business since 1905. When the petitioner's corporation was organized in 1905, it acquired several sugar estates and 5,630 shares of the common stock of the Guantanamo Railroad Company in exchange for

39,990 shares of its own common stock of a par value of \$100.00 each. The stock of the Guantanamo Railroad Company thus acquired was set up on petitioners books at \$75.00 a share or \$422,250 (Exhibit 1 and 5). Petitioner subsequently between the years 1905 and 1908, purchased at various times 1,066 additional shares of stock of the Guantanamo Railroad Company at a total cost of \$35,069.02. As of February 20, 1908, petitioner's books showed the total cost of 6696 shares of the common stock of the Guantanamo Railroad Company to be \$457,319.02. This stock has never been sold and is still owned by the petitioner (R. 44).

At the hearing before the Board the petitioner waived its right to claim \$8,138.79, representing the cost of additional shares of the stock of the Guantanamo Railroad Company purchased subsequent to 1908, being the difference between the amount claimed in its amended petition and the amount shown by the books introduced in evidence because of the small amount involved and the difficulty of proof (R. 29) and respondent agreed to waive any objection to any inconsistency of the pleadings and petitioner's records on that point.

Until 1907 there was no railroad in Guantanamo Valley other than the line which had been built many years previously and which was being operated by the Guantanamo Railroad Company. At that time there were seven sugar estates located in the vicinity of the railroad which shipped their products over its lines. These estates were owned by different persons, but in 1905 petitioner acquired four of these estates along with the railroad stock and commenced to operate the railroad as an integral part of its business (R. 52, Exhibit 5). It is a standard guage road, running from

Guantanamo east to Jamaica and west to Soleda and is equipped to move freight and to operate passenger trains (R. 28). Before 1907 it was one of the most important railroads in Cuba. In 1905 it built some spur tracks on the property of petitioner, which tracks belong to the railroad company. It had buildings and stations and 54.456 kilometers of rails, 6 locomotives, 7 passenger coaches, 3 baggage cars, and 128 freight cars. (R. 75, 77). It also had a repair shop and a yard for freight and passenger cars. It had one dock which was located at the end of the railroad and an iron foundry (R. 51, 52). At the present time it runs from 85 to 100 miles and has trains for moving freight and regular passenger trains (R. 45). It takes from 500 to 1000 persons per day back and forth from the naval station and carries a great many passengers who go to intermediate points on the road. In addition to that, it also hauls the cane and the raw products of the Guantanamo Sugar Company and all materials to a distance of 85 miles. It has the best shipping facilities on the Island of Cuba, and the road is in excellent shape (R. 45-49).

The minute book of the Guantanamo Railroad Company, which was admitted in evidence, showed the net income of the company for the years 1900 to 1905, inclusive, and the dividends declared for those years as follows:

Year	Income	Dividends
1900	\$60,767.20	5½%
1901	23,880.57	5%
1902	47,192.94	3%
1903	11,837.88	0
1904	11,104.13	0
1905	59,722.24	0
(R. 53, 54, 55, 56, 57, 58, 59)		

The petitioner introduced in evidence a report by certified public accountants, showing the condition of the railroad company as of December 31, 1905, in lieu of the original books covering that year, which had been destroyed by fire in 1907 (R. 51, Exhibit 6). This report confirmed the oral testimony of a witness who had helped prepare it and testified that the figures had been correctly taken from the original books (R. 50). The report contained a balance sheet and profit and loss account for the year ending December 31, 1905 (R. 80, Exhibit 6). The balance sheet showed capital and surplus as of December 31, 1905, of \$1,379,488.33 which would give a book value of more than \$137.00 per share. It states a surplus as of January 1, 1905, to have been \$320,568.62 which would give a book value as of that date of \$132.00 per share. It showed total liabilities of \$242,807.27 of which \$186,000. was owed to petitioner, which indebtedness could not have existed at the time the stock was acquired by petitioner at its organization (R. 80—Exhibit 6).

In 1907 a competing railroad was constructed in the locality of the Guantanamo Railroad Company and thereafter the sugar estates, in the vicinity which were not owned by the petitioner, began to ship their products over the new line. The petitioner continued to use and operate the Guantanamo Railroad Company in its own business and hauling passengers, and it advanced considerable sums of money to the railroad company from time to time—until—by the end of 1918, petitioner had loaned and advanced the Guantanamo Railroad Company approximately \$1,000,000. which amount was still outstanding (R. 28). It may be inferred that some of these loans or advances were to

enable the railroad company to build the spurs of tracks on petitioner's property. At the time of the hearing there was 10,000 shares of the stock of the railroad company outstanding of which the petitioner owned about 8,900 shares and officers of the petitioner are officers of the railroad company (R. 45).

At a meeting held by the Board of Directors of petitioner on December 13, 1911, it was resolved by the Directors that the cost of the shares of the Guantanamo Railroad Company should be carried on the books at a nominal value of \$1.00, and it was further resolved that there should be written off the cost of property the total sum of \$768,287.25, of which amount the sum of \$465,457.81 represented the shares of stock of the Guantanamo Railroad Company owned by petitioner at that time. In accordance with this resolution, the several property accounts were reduced and there was charged to surplus, as of December 30, 1911, the total sum of \$768,287.25 (R. 43, 44; Exhibit 5). This amount was not included as invested capital in the returns filed by the petitioner for the years 1918, 1919 and 1920 (R. 29). In the amended petition filed with the United States Board of Tax Appeals for the years 1918, 1919 and 1920, the petitioner claimed the right to have its invested capital increased by the amount of \$768,287.25, the actual cost of the assets written down on its books as of December 13, 1911, and its taxes, excess profits recomputed on that basis (R. 24, 25). At the hearing before the United States Board of Tax Appeals, the petitioner waived its right to have added to its invested capital for the years involved any amount in excess of \$457,319.02, representing a part of its investment in the stock of the Guantanamo Railroad Company (R. 44).

The United States Board of Tax Appeals held that because the stock of the Guantanamo Railroad Company acquired by petitioner from 1905 to 1908 and owned by it in the taxable years, did not retain its invested capital value and did not continue to be valuable, it could not be included in its invested capital in the excess profits tax returns filed for the years involved and gave judgment for the respondent (R. 30-31) from which judgment this petition for review is filed.

The petitioner filed a motion to have the memorandum opinion reviewed by the whole Board which motion was denied on the 12th day of September, 1934 (R. 36).

SPECIFICATION OF ERRORS TO BE URGED.

The Board Erred.

1. In determining that the value of 5,630 shares of the Stock of the Guantanamo Railroad Co. paid in to petitioner at the time of its organization for the issue of petitioner's shares of stock to be included in its invested capital for the fiscal years ended September 30, 1918, and September 30, 1920, was the sum of \$1.00, to which the same had been written down on the 30th day of December, 1911, instead of the actual cash value of said shares of stock at the time it was paid in to and acquired by petitioner.

2. In holding as a matter of law that because petitioner failed to prove that said 5,630 shares of stock continued to be valuable, the value of the same at the time of acquisition may not be restored to the invested capital of petitioner for the fiscal years here involved.

3. In holding as a matter of law that the actual value of said 5,630 shares of stock of Guantanamo Railroad Company when acquired may not be restored to the invested capital of petitioner for said fiscal years because said shares had been written down on the 30th day of December, 1911, to the sum of One Dollar (\$1.00).

4. In holding as a matter of law that petitioner was not entitled to have included in its invested capital for said fiscal years the actual value of said 5,630 shares of stock of Guantanamo Railroad Company held by petitioner during each of said fiscal years, and bona fide paid in to petitioner for the stock or shares of petitioner, at the time of such payment.

5. In holding as a matter of law that the actual cost to petitioner of 1,066 shares of the stock of said Guantanamo Railroad Company, purchased by petitioner between the 30th day of September, 1905, and the 20th day of February, 1908, may not be restored to the invested capital of petitioner for the fiscal years here involved, for the reason that said shares together with other shares had been written off by petitioner on the 30th day of December, 1911, to the sum of One Dollar (\$1.00).

6. In holding as a matter of law that petitioner was not entitled to have included in its invested capital for said fiscal years the actual cost to petitioner of 1,066 shares of the stock of Guantanamo Railroad Company purchased by petitioner between the 30th day of September, 1905, and the 20th day of February, 1908, and held by petitioner during each of said fiscal years.

7. In failing to find as a matter of fact that the actual cash value of said 5,630 shares, paid in to petitioner for its stock or shares at the time of such payment was the sum of \$75.00 a share, or the total sum of \$422,250.

8. In holding as a matter of law and facts that petitioner was not entitled to have restored to its invested capital for the fiscal years ended September 30, 1918 and September 30, 1920, the sum of \$457,319.02, the cost and the actual cash value of 6,696 shares of stock of Guantanamo Railroad Company at the time of the acquisition of the shares by petitioner and owned by petitioner during said fiscal years.

9. The Board erred in ordering and determining that there was a deficiency in income, excess profits and war profits taxes of petitioner for the fiscal year ended September 30, 1918, in the sum of \$2,147.95.

10. The Board erred in ordering and determining that there was a deficiency in income and excess profits taxes of petitioner for the fiscal year ended September 30, 1920, in the sum of \$52,568.24.

11. The Board erred in denying the motion made by petitioner for the review by the whole Board of the memorandum opinion, rendered the 31st day of July, 1934.

ARGUMENT.

In determining petitioner's right to the restoration to Invested Capital of the value of the shares of stock of the Guantanamo Railroad Company written down on its books on December 30, 1911, it is necessary to consider first, the right to restore the 5630 shares orig-

inally paid in for stock; second, the actual cash value of such shares at the time they were paid in, and third, the right to restore the cost of the shares subsequently purchased. These three points will be taken up in their order.

POINT I.

Petitioner is entitled to have restored to its invested capital for the fiscal years ending September 30, 1918 and September 30, 1920, the actual cash value of 5630 shares of stock of the Guantanamo Railroad Company acquired by petitioner at the time of its organization by the issue of its stock and written down on its books on December 30, 1911.

It is difficult to see upon what theory it can be urged that under the facts disclosed by the record, petitioner is not entitled to have restored to invested capital the write-down on its books of the value of 5630 shares of Guantanamo Railroad Co. stock, acquired by petitioner upon its organization in exchange for its stock. Article 842 of Regulations 45, quoted before, expressly recognizes this right, and if there had not been any such regulations, the wording of the statute and the theory of invested capital, as expounded by the Supreme Court of the United States and the Circuit Courts of Appeals and the Board of Tax Appeals would unquestionably give it such right.

Under Section 326 (a) of the Revenue Act of 1918, invested capital is made up of two parts: (1) the amount paid into the corporation for its stock or shares, either as capital or as paid in surplus; (2) surplus and undivided profits subsequently earned and not distributed as dividends. The first part is fixed and

nothing except a return of capital to the stockholders can ever decrease it. Earned surplus and undivided profits may, of course, be affected by impairment of capital by operating deficits and other causes, but the amount paid in for stock remains unchanged. This conception of invested capital was laid down by the Supreme Court of the United States in the case of *La Belle Iron Works v. United States*, 256 U. S., 377. In that case the taxpayer, a domestic corporation, had prior to the year 1904 acquired ore lands for which it paid the sum of \$190,000. Between that time and the year 1912 extensive exploration and developments were carried on and it was proved that the lands contained large bodies of ore and had an actual cash value of not less than \$10,105,400 during the years 1912-1917. In the year 1912 the company increased the valuation of said land upon its books by adding thereto the sum of \$10,000,000 which it carried to surplus, and in the same year declared a stock dividend in the sum of \$9,915,400, representing the increase in value of the ore land. In returning its annual net income for the year 1917 for income and excess profit taxes, the company included in its invested capital the sum of \$10,135,400, as representing the value of the ore lands. The Supreme Court held that the taxpayer could not include the increased value of the ore lands as of 1912 in its invested capital, but could only include the amount of \$190,000, the original cost of such lands to it. That case is the converse of this, in that there the taxpayer attempted to include in its invested capital the value of assets which had been written up on its books. The case was decided under Title II of the Revenue Act of 1917, the provisions of which are substantially similar to those of Title III of the Rev-

venue Act of 1918. The Court, by Justice Pitney, says at Page 388:

“When speaking of the capital of a business corporation or partnership, such as the Act deals with, ‘to invest’ imports a laying out of money, or money’s worth, either by an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business; in either case involving a conversion of wealth from one form into another suitable for employment in the making of hoped-for gains. See Webster’s New Internat. Dict.

“In order to adhere to this restricted meaning and avoid exaggerated valuations, the draftsman of the Act resorted to the test of including nothing but money, or money’s worth, actually contributed or converted in exchange for shares of the capital stock, or actually acquired through the business activities of the corporation or partnership (involving again a conversion) and coming in *ab extra*, by whatever increase over the original capital stock. How consistently this was carried out becomes evident as the section is examined in detail. Cash paid in, and tangible property paid in other than cash, are confined to such as were contributed for stock or shares in the corporation or partnership; and the property is to be taken at its actual cash value ‘at the time of such payment’—distinctly negating any allowance for appreciation in value.”

At Pages 389 and 390 it is stated:

“It is clear enough that Congress adopted the basis of ‘invested capital’ measured according to actual contributions made for stock or shares and actual accretions in the way of surplus, valuing

them according to actual and bona fide transactions and by valuations obtained at the time of acquisition, not only in order to confine the capital, the income from which was to be in part exempted from the burdens of this special tax, to something approximately representative of the risk accepted by the investors in embarking their means in the enterprise, but also in order to adopt tests that would enable returns to be more easily checked by examination of records, and make them less liable to inflation than if a more liberal meaning of 'capital and surplus' had been adopted; thus avoiding the necessity of employing a special corps of valuation experts to grapple with the many difficult problems that would have ensued, had general market values been adopted as the criteria."

If Congress in its definition of invested capital intended that the amount of the investment plus acquisitions made through earnings should be the measure of invested capital, it is obvious that a bookkeeping transaction involving the marking up or down of the value of property invested cannot change the amount of that investment. If assets written up do not go into invested capital at their appreciated values, no more should assets written down be deducted therefrom. In each case the amount of the investment remains unchanged.

Thus, it has been held that an operating deficit suffered by a corporation in preceding years cannot be used to decrease any amount going into invested capital as part of the investment in the corporation. In the case of *Ralston Steel Car Co. v. Commissioner*, 53 Fed. (2nd) 94, involving the valuation of the invested capital of the corporation to be used in assess-

ing excess profit taxes under Revenue Act of 1918, the Court said (at Pages 949 and 950) :

“In computing the amount of the ‘invested capital’ of a corporation to be used in assessing Federal Excess Profit Taxes, the definition contained in the pertinent Act is controlling. Two general factors must be taken into consideration; (1) the amount (in money or money’s worth) actually paid in for capital stock and as surplus; and (2) the amount of earned surplus and undivided profits used or employed in the business. Borrowed money, although used in the business, may not be included; nor is the amount of the surplus to be affected by an increment in the value of fixed assets after the same were acquired. *La Belle Iron Works v. United States*, 256 U. S., 377, 41 S. Ct. 528, 65 L. Ed. 998. Subject also to the other limitations therein provided, tangible or intangible property paid in for capital stock is to be taken at its money value at the time of payment. Neither the value of such property during a later tax year, nor the March 1, 1913 value, is of importance in fixing the initial amount of capital and paid in surplus, that is, the ‘invested capital’ with which the company started business.

“If the ‘invested capital’ becomes impaired by the operation of the business, the amount thereof to be used in computing excess profits taxes nevertheless remains the same as before such impairment. The amount paid in for capital stock or as surplus forms a minimum, and is not affected by subsequent operating losses.”

In the case of *Gauley Mountain Coal Co. v. Commissioner of Internal Revenue*, C. C. A. Fourth Circuit, 23 Fed. (2nd) 574, the Court held that payment made by the coal company to a railroad, through reduction in the price of coal furnished the railroad under a con-

tract made in 1889 to furnish coal for ten years, at 25 cents per ton less than the market price, in consideration of the railroad's agreement to build a branch line to its coal lands, constituted invested capital for the purposes of computing income and excess profit taxes within the Revenue Acts of 1918. The Court said, at Page 576, in commenting upon the meaning of the language of the Supreme Court in the case of *La Belle Iron Works v. United States*, *supra*:

“In the light of this language of the Supreme Court, we think it is clear that, to constitute invested capital there must have been (1) a laying out of money or money's worth, and (2) the acquirement of something of permanent use or value in the business. The questions in this case, therefore, are; Was the furnishing of coal under the contract at less than market price the laying out of money or money's worth? and was the railroad connection acquired thereby a thing of permanent use or value in the business of the taxpayer? We think that both of these questions must be answered in the affirmative.”

In the case of *Rookwood Pottery Co. v. Commissioner of Internal Revenue*, C. C. A. Sixth Circuit, 45 Fed. (2nd) 43, the Court held that the taxpayer, which when incorporated in 1890 had issued a stock for intangibles, was entitled to include the value of same in its invested capital for the years 1921 and 1922, although the corporate directors did not continue to carry the intangibles issued for the stock on its books. The Court said, at Page 45:

“The facts appearing as they do it becomes of negligible importance that the directors had not continued to carry these intangibles as an asset on the books. The fact is no more important here

than it would be if the corporation had paid for the intangibles in cash instead of in stock. The cutting out of this class of assets from the capital stock account was in accord with the best and the most prudent practice of the time."

In the case of *Pioneer Pole & Shaft Co. v. Commissioner of Internal Revenue*, C. C. A. Sixth Circuit, 55 Fed. (2nd) Page 61, the Court held that where a successor corporation had decreased the par value of common stock without change in the number of shares, it did not prevent allowance for good will as an item of invested capital in accordance with appraisement on the organization of the original corporation.

See also the case of *News Publishing Co. v. Blair, Commissioner of Internal Revenue*, 58 App. D. C. 295, 29 Fed. (2nd) 955.

This same principle has been laid down by the Board of Tax Appeals in the case of *Appeal of Guarantee Construction Co.*, 2 B. T. A. 1145, in which it is said at Page 1151:

"Invested capital, within the meaning of Section 326 of the Revenue Act of 1918, is the capital actually paid in to the corporation by the stockholders plus certain earned surplus and undivided profits. The stockholders of the corporation originally paid in for its capital stock cash or tangible property of a total value equal to the par value of the stock issued. The amount invested in the corporation was, therefore, equal to the par value of its capital stock. While it is true that in this appeal the capital of the taxpayer was obviously impaired or depleted, at the beginning of each of the years 1911, 1912 and 1913, to the extent of the deficit then existing, the amount invested in the corporation by the stockholders, however, remained unchanged. It was still equal to the par

value of the outstanding stock. Section 326 of the Revenue Act of 1918 makes no provision for the reduction of invested capital of a corporation by reason of an operating deficit. It provides, and we think with reason, that invested capital shall at all times include capital or surplus actually paid in. Earned surplus and undivided profits, of course may vary in amount from year to year. We are of the opinion, therefore, that capital and surplus actually paid in remain part of the invested capital of a corporate taxpayer, except where such capital or surplus has been directly or indirectly returned to the stockholders."

To the same effect is the case of *Reading Hardware Co. v. Commissioner of Internal Revenue*, 7 B. T. A. 337, in which it is said at Page 355:

"The reason for the rule, which has been generally applied in an interpretation of the Revenue Act of 1917 and 1918, that capital or surplus actually paid in is not required to be reduced because of an impairment of capital in the nature of an operating deficit, is based on the proposition that the several acts do not require such a reduction and contemplate that invested capital shall at all times include capital or surplus actually paid in until there has been a liquidation or return of the original investment to the stockholders."

The Board of Tax Appeals has held in several cases that where capital assets had been written down or charged off the books in years prior to the imposition of excess profits tax, they may be restored to invested capital for the purpose of determining excess profits tax in subsequent years. See *Welsh Packing Co. v. Commissioner of Internal Revenue*, 9 B. T. A. 1169; *Ault and Wiborg Co. v. Commissioner of Internal Revenue*, 10 B. T. A. 183; *Trace Mining Co. v. Commissioner of Internal Revenue*, 15 B. T. A. 872.

It is therefore established, in accordance with the doctrine pronounced in the foregoing cases, that the amount of cash or the cash value of property invested in a corporation in exchange for its stock or shares or cash must be included in its invested capital for excess profits tax purposes and must not be reduced even if the corporation no longer has this property on hand. The meaning of invested capital is clear. It is the actual investment, subject to certain limitations on intangibles, which the shareholders have made in the corporation plus such further amounts as have subsequently been earned by the corporation and are in the business during the taxable year. The first of these elements also remains fixed until it is returned to the stockholders. It cannot be changed by any increase in the value of the property invested nor by any decrease thereof. Even if part of the property invested is lost, the amount of the investment remains the same; a fortiori, it cannot be affected by any entries on the books writing up or down the value of property invested for accounting purposes. It cannot be said that the action of petitioner's Board of Directors, in ordering the capital assets written down, must be presumed to be correct, and that it must show that such action was erroneous. It is wholly immaterial whether or not the action of the Board of Directors was correct. If their judgment were absolutely correct and if the railroad company stock had become absolutely worthless on December 30, 1911, and by all sound accounting principles it should have been written down to \$1.00, this does not change the value of the investment made in petitioner's stock at the time it was acquired, and it is this value and this value alone which the statutes and the decisions declare shall be taken to determine petitioner's invested capital.

It is for this reason that Article 842 of Regulations 45 does not require any showing of the erroneousess of the write-off before permitting restoration to invested capital. No more does it require a showing that the property written down had a value during the taxable year. The memorandum opinion of the Board holds that, before assets which had been written off the books of the corporation may be restored to surplus or its invested capital for a taxable period, it must be established that such assets are still existent and still owned by the corporation at the beginning of the period in question, and that the assets have retained their invested capital value, and that the petitioner had not shown that this stock continued to be valuable. It is submitted that this contention is erroneous and immaterial. Even if the stock had been lost or sold or abandoned as worthless, the investment of petitioner's shareholders would have remained the same and it is the value of this investment at the time it was made which is determinative of the amount of petitioner's invested capital. It is also not important that petitioner did not claim this restoration in its returns or in the original petition filed with the Board. The amended petition was filed pursuant to leave granted and was answered by the respondent. It tendered the issue of the restoration to invested capital of the amount of the write-off of the Guantanamo Railroad Company's stock which had been paid in for petitioner's stock or shares. The restoration of this amount will affect the deficiencies proposed against the petitioner and it is entitled to have its right to such restoration determined, however ignorant or lax in asserting its rights it may formerly have been. For the reasons set forth above and upon the authorities

cited, it is submitted that the memorandum opinion of the Board of Tax Appeals is erroneous and petitioner is clearly entitled to the restoration to its invested capital for the fiscal years here involved, of the actual value of the 5630 shares of the Guantanamo Railroad stock at the time it was acquired for its stock and subsequently written down on the books.

POINT II.

The actual cash value of 5630 shares of stock of the Guantanamo Railroad Company at the time the same were acquired by petitioner by the issue of its stock was not less than \$75 per share or a total of \$422,250.

At the first meeting of the Board of Directors of petitioner, an offer was made to convey to petitioner four sugar estates and 5630 shares of stock of the Guantanamo Railroad Co. in exchange for the issue of 39,990 shares of stock of petitioner of the par value of \$100 each. This offer was accepted (R. 67, 70) and the property was paid in and the stock was issued accordingly. The railroad company's shares acquired by petitioner at the time of its organization were tangible property, under the definition of Section 325 (a) of the Revenue Act of 1918, paid in for stock or shares, and therefore should go into invested capital at the actual cash value at that time. Since these shares were, together with others subsequently acquired, written down to \$1.00 and since petitioner seeks to have the same restored to invested capital, it was necessary to show the cash value at the date of acquisition from the best evidence available. Under Article 842 of Regulations 45, property may be restored to invested capital only at the value at which it might have been included therein had the write-off not been made.

There was no evidence of sales of this stock in 1905, except sales to petitioner. There was evidence of further sales in small lots to the petitioner subsequent to 1905, after it had acquired control. In order, therefore, to establish the value of the original shares at the time of acquisition by petitioner, petitioner offered oral testimony in regards to the assets and earnings of the railroad company at that time, of witnesses who were familiar with the assets of the railroad company. It also introduced in evidence a report of a firm of certified public accountants, identified by a witness who had helped prepare it from the original books, and who was in charge of the books at the time. This report contained a balance sheet and a profit and loss statement as of December 31, 1905. This report was produced in lieu of the original books of the railroad company, which had been destroyed by fire in 1907. The balance sheet showed a book value of \$137 a share as of December 31, 1905.

There can be no doubt that a balance sheet must be considered in determining the value of stock. In this instance, there is a detailed analysis of the assets and a statement of the indebtedness showing that at the time the stock was acquired by petitioner the railroad company had practically no indebtedness. The petitioner did not ask the Board to find the market value of the stock as equal to the book value; it, itself, placed a value of \$75.00 a share on the stock which is only 57 per cent of the book value. It is contended that the earnings made and the dividends paid by the railroad company taken in conjunction with the book value and the value of petitioner's shares issued for it, clearly show that the value of \$75.00 a share is justified. The minute book of the railroad company shows that dur-

ing the years 1900-1905 inclusive, the railroad company earned the following amounts net:

1900	\$60,767.00
1901	23,880.37
1902	47,192.94
1903	11,837.88
1904	11,104.15
1905	59,722.24
Total	\$214,504.58

This is an average of \$35,750.76 per year—despite a cyclone in 1901, which did the railroad company severe damage, and apparently exceptional expenses and replacements in 1903 and 1904, which, by the system of bookkeeping employed, reduced the net income in these years to slightly more than 1 per cent of the par value of the outstanding capital stock. Capitalizing the earnings at 5 per cent, a reasonable rate in the year 1905 would have given a value of \$71.50 per share for the stock.

The dividends paid by the railroad company for the five years preceding the time when petitioner took control were as follows:

January 1901 (for 1900)	5.5%
July 1902 (for 1901)	5%
January 1903 (for 1902)	3%
January 1904 (for 1903)	0
January 1905 (for 1904)	0
Total	13.5%

Even in bad years, the railroad company never operated at a loss. When petitioner acquired the stock in June 1905, the busy, and therefore the profitable season of the railroad company was about ended and

the earnings for that year had been large. The railroad was a public utility. At the time this stock was acquired by the petitioner, it was the only railroad in that neighborhood, serving a number of sugar plantations, and continued so until a competing railroad was built in 1907. It had, therefore, a stable business, as is shown by the gross earnings of the railroad company for the years 1900-1905, which in round figures were: \$175,000, \$180,000, \$168,000, \$190,000, \$155,000 and \$188,000 respectively. This stability of business would be considered by a prospective investor and would justify the higher price for the stock. See *S. W. Fidelity Title & Trust Co. v. Commissioner of Internal Revenue*, 10 B. T. A., 482, at Page 488.

Furthermore, the 5630 shares of stock of the railroad company constituted control. A block of stock which carries with it control of the corporation may have a higher value than a block in which the element of control is absent. See *Couzens v. Commissioner of Internal Revenue*, 11 B. T. A., 1040, in which it is said at Page 1161:

“While reason does not admit that a block of stock would be worth more when bought from A than when bought from B, it is altogether possible that such a block would command a higher yet fair price if it represented the balance of power or control over the corporate business.”

That control in this instance was important appears clearly from the evidence. After petitioner acquired control, the railroad was operated as an integral part of its business, and petitioner did not have to depend upon an outside railroad in order to move its sugar.

No dividends were paid after petitioner secured control. For this reason the subsequent purchases of

stock at \$35.00 a share are not controlling. This price shows that the stock had a substantial value but these purchases are not evidence of the value of the stock at the time of acquisition by petitioner. It must have been apparent to every stockholder that the only prospective purchaser of the stock was petitioner and that it was in a position to purchase at its own price and on its own terms. Furthermore, this is a case where there is no presumption of the correctness of a valuation by respondent—in fact, the respondent has never yet made a valuation. It was admitted that this stock, along with the stock subsequently purchased, had been written down to \$1.00, and it is certain that the stock had an actual cash value greater than \$1.00.

Petitioner having produced evidence substantiating the value set up on its books, and there being no valuation by the respondent, and petitioner's proofs being unchallenged by contrary proofs or destructive analysis, the valuation by petitioner was *prima facie* correct and it was the function of the Board to find that value.

In the case of *Rookwood Pottery Co. v. Commissioner of Internal Revenue*, 45 F. (2d) 43, which reversed a decision of the Board of Tax Appeals, it was held that a valuation ascribed to intangibles by organizers of the corporation at the time of its organization, was correct and should be included in invested capital. The Court stated at page 45:

“The opinion of the Board shows that it regarded the taxpayer as under the legal burden of proving this value ‘with certainty’. And upon this basis it concluded that uncertainty remained. In this premise we think the Board was in error. We see no reason why the taxpayer did not make its case when it put in proofs clearly and dis-

tinctly tending to show this value; and when the proofs so introduced remained unchallenged by contrary proofs or by destructive analysis, it was the duty of the Commissioner to decide the issue in accordance with the proofs then appearing before him; and it was, we think, the duty of the Board to take the same view. The Blackstonian 'certainty to a common intent' ought to be sufficient. * * *

In the case of *Consumers Ice Co. v. Burnett, Commissioner of Internal Revenue*, Court of Appeals, District of Columbia, 50 F. (2d) 341, this court reversed a decision of the Board of Tax Appeals, which had not allowed any value for riparian rights acquired by the taxpayer in 1894, by issue of its stock, and to include such value in its invested capital for the years 1920 and 1921. In this case the taxpayer had acquired certain riparian rights by issuing therefor \$34,200, par value, of its stock, and in the same year it acquired other riparian rights by payment of \$2,000 and \$2,500, which were much less valuable than those acquired for shares of stock. The Board allowed the taxpayer to include in its invested capital the value of the riparian rights acquired for cash but did not allow any value for those acquired for its capital stock. The court said:

"* * * The Board ruled that there was no evidence 'as to the value of the riparian rights as of the time the petitioner (appellant) acquired them nor of the value of the stock issued therefor.' While the Board apparently recognized that these riparian rights possessed very substantial value, and that without them the company could not have done business at all, nevertheless it refused to place any value whatever upon them, thus elim-

inating from invested capital the value of these acquired rights. In our view the Board erred.

“During the same year, the Underwood and Paul rights were secured for a cash payment of \$4,500. This amount the Board has allowed. The evidence is convincing that riparian rights (on the level of the lakes) acquired on the organization of the company were of far greater value than those acquired from Underwood and Paul, and yet the Board made allowance in full for the latter and allowed nothing for the former. The good faith of appellant is not questioned. The Board was satisfied that capital stock in the par value of \$34,200 was issued for the riparian rights acquired. It was also satisfied that \$4,500 cash was paid for rights of far less value. In our view, there was sufficient evidence to justify and require the Board to place a value of at least \$4,500 upon the riparian rights acquired for which stock was issued. * * *

Section 49, New Jersey, Compiled Statutes, 1709-1910, Volume II, page 1630, of the Corporation Laws of the State of New Jersey under which petitioner was incorporated, provides as follows:

“Any corporation formed under this Act may purchase mines, manufacturing or other property necessary for its business or the stock of any company or companies owning, mining, manufacturing or producing materials, or other property necessary for its business, and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be fully paid stock and not liable to any further payment under any of the provisions of this act; and in the absence of actual fraud in the transaction, the judgment of the directors as to the value of the property purchased shall be conclusive; and in all statements and reports of the corporation to be pub-

lished or filed, this stock shall not be stated or reported as being issued for cash paid to the corporation, but shall be reported in this respect according to the fact." (P. L. 1896, p. 293)

In interpreting this statute the New Jersey Courts in the case of *Donald v. Refining Company*, 62-E-729, 48A 771, 1116, reversing 61-E 458, 48A 786 held:

"After stock has been issued as full-paid stock for property purchased, the judgment of the directors as to the value of property becomes conclusive, in the absence of actual fraud in the transaction, and such stock is not liable to any further call."

It is contended that under the law under which petitioner was incorporated, there is a presumption that the judgment of the directors as to the value of the property acquired for stock is conclusive, and would not be set aside in the absence of a showing of actual fraud in the transaction. Therefore, the value ascribed to this stock by the petitioner's directors, when it was acquired, was conclusively correct.

In the case of *Bookwood Pottery Co. v. Commissioner of Internal Revenue*, *supra*, the Court said:

"The law of Ohio, doubtless familiar to the organizers and their counsel, were permitted property to be used in payment for stock only at the actual cash value of the property, and these organizers and their advisers cannot now be presumed to have intended a violation of this law."

In the case of *Planters Operating Co. v. Commissioner of Internal Revenue*, C. C. A. Eighth Circuit, 55 Fed. (2nd) 583, the Court had under consideration the question of the value ascribed to a lease by the Board

of Directors of the corporation at the time of its acquisition, and reversed the Board of Tax Appeals which held that it had no value and determined the value to be the amount ascribed to it by its Board of Directors at the time of acquisition. The Court stated at Page 586:

“It is to be noted that the purchase of the lease by the petitioner was approved both by the Board of Directors and by the stockholders of the petitioner. It should be further noted that Section 8, Article 12, of the Constitution of Missouri and Section 9740 of Revised Statutes of Missouri, 1919, both plainly contemplate that stock of a corporation should be issued only for something of value, as cash, labor or property. * * * It presumes that the petitioner corporation acted lawfully instead of unlawfully in the issuance of its stock and that the lease purchased had value.”

Now, similarly in *Sioux City Stockyards Co. v. Commissioner of Internal Revenue*, C. C. A. Eighth Circuit, 59 Fed. 944, *Gauley Mountain Coal Co. v. Commissioner of Internal Revenue*, C. C. A. Fourth Circuit, 23 Fed. (2nd) 574.

It is submitted that upon the facts and records of this case, the value of the 5630 shares of the Guantamo Railroad Co. acquired by petitioner for its stock was on June 19, 1905, not less than \$75.00 per share and a total of \$422,250.00.

POINT III.

Petitioner is entitled to have restored to its invested capital for the fiscal years ending Sept. 30, 1918 and Sept. 30, 1920, the sum of \$35,069.02 the cost of 1066 shares of stock of the Guantanamo Railroad Company purchased between September 30, 1905 and February 20, 1908.

The evidence shows that between September 30, 1905 and February 20, 1908, petitioner purchased 1066 shares of the Guantanamo Railroad Co. at a total cost of \$35,069.02. There is no question of valuation in respect to this stock. It was purchased for cash. The only question to be determined here is whether an asset purchased for cash and subsequently written down on the books may be restored to invested capital at the amount of its purchase price. Article 840 and 841 of Regulations 45, the decision of the Federal Courts and the Board of Tax Appeals and the rulings of the Bureau of Internal Revenue all agree that it may. While this case is not specifically mentioned in neither of the Articles of the Regulations above referred to, it is clear that it comes within the scope of the same. These Articles were designed to permit the restoration to invested capital of assets which, through excessive depreciation, erroneous charges to expense of items which should have been capitalized for reasons of conservation or otherwise have been written below the real cost.

This is clearly the case presented here. Petitioner purchased these additional shares for the amount shown on the books. Subsequently it wrote them down to \$1.00, although it still retained the shares and still operated the railroad as part of its business. If the

write-off had not been made, these shares would have been included in petitioner's invested capital at their cost. To reduce its invested capital by the amount of the write-down when it still had the stock would be erroneous and would be penalizing petitioner for an accounting error. Articles 840 and 841 are expressly designed to relieve against such injustice. Some of the Bureau of Internal Revenue Rulings on this point follow.

T. B. R. 8, 1 C. B. 290, reads as follows:

“(1) where a distilling corporation pursuant to a resolution of the board of directors charged against surplus in 1912 and 1913 amounts aggregating—dollars on the ground of alleged obsolescence a part of its equipment and the entire equipment was continued in use, the same as previously, no reduction of output being made and no portion of the property having been retired or scrapped, in fact no change being made beyond the arbitrary reduction of the surplus and invested capital by charging off the—dollars on the books of the corporation, it having been shown that these charges were made only for the consideration of the corporation and that they had not entered into the corporation's income tax returns, the amounts so charged off may be restored to invested capital, less proper allowance for ordinary depreciation.”

To the same effect is I. T. 1, 347, 1-1 C. B. 370, which reads as follows:

“If a corporation employed its own labor in the construction of its plant, such as building of machine foundations and in the installation and assembling of machines and other equipment, the value of the labor so employed represented a capital expenditure which may be included in invested capital. If the value of such labor was deducted

as an expense in excise and income tax returns for years prior to 1917, it may be restored to invested capital at its depreciated value, provided amended returns are filed for each year during which a deduction from income was made, in which returns the amended net income shall be increased by the value of the labor previously deducted as an expense.”

The Board also adopted the same view in *Trace Fork Mining Co. v. Commissioner of Internal Revenue*, 15 B. T. A. 572, in which it was held that the value of certain houses for employees, which had been carried on the books at much less than the cost, should be restored to invested capital at their actual cost less depreciation. Similar cases are *Ault and Wiborg v. Commissioner of Internal Revenue*, 10 B. T. A. 183, *Welsh Packing Co. v. Commissioner of Internal Revenue*, 9 B. T. A., 1169. See also *News Publishing Co. v. Blair, Commissioner of Internal Revenue*, 58 Appeals, D. C., 295, 29 Fed. (2nd) 955.

From these rulings and decisions of the Board of Tax Appeals and the Courts, it is clear that the cost of these additional shares purchased should be restored to invested capital at the actual cost to petitioner. There is no question here of depreciation, since this stock was not a depreciable asset. Nor is there any question of an amended return, since these additional shares were not charged to expense, but, as shown by petitioner's exhibit No. 1, were carried in a capital account, the Guantanamo Railroad Company investment account, and were written off.

It is submitted that the cost of these additional shares purchased for cash should be restored to invested capital, together with the value of the shares acquired for stock on the organization of petitioner.

CONCLUSION.

It is, therefore, contended that the memorandum opinion of the Board of Tax Appeals is erroneous and contrary to the decisions of the Supreme Court of the United States, the Circuit Courts of Appeal, and other decisions of the Board of Tax Appeals—and that the memorandum opinion should be reversed and the value of the shares of stock in the Guantanamo Railroad Co. at the time of acquisition by the petitioner, in exchange for its shares of stock, should be restored to the invested capital of petitioner for the fiscal years ending September 30, 1918 and September 30, 1920, the sum of \$457,319.02, and the excess profits taxes of petitioner for said fiscal years be redetermined accordingly.

Respectfully submitted,

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UNITED STATES
COURT OF APPEALS
DISTRICT OF COLUMBIA

FILED MAR 6 - 1936

Henry H. ...

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No. 6458

**In the United States Court of Appeals
for the District of Columbia**

GUANTANAMO SUGAR COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

ROBERT H. JACKSON,
Assistant Attorney General.

SEWALL KEY,
J. LOUIS MONARCH,
HARRY MARSELLI,
Special Assistants to the Attorney General.

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OPINION BELOW

The sole previous opinion in this case is the memorandum opinion of the Board of Tax Appeals rendered July 31, 1934 (R. 36-42¹), which is unreported.

JURISDICTION

This petition for review involves income and excess profits taxes for the fiscal years ended September 30, 1918, and September 30, 1920, in the respective amounts of \$2,147.95 and \$52,568.24, and

¹ Unless otherwise noted, references are to *folios* of the printed record.

is taken from a decision of the Board of Tax Appeals entered July 31, 1934 (R. 43). The case is brought to this Court by petition for review filed October 30, 1934 (R. 45-52), by agreement between the parties (R. 44), pursuant to the provisions of Sections 1001-1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169, and by Section 519 of the Revenue Act of 1934, c. 277, 48 Stat. 680.

QUESTION PRESENTED

Under the circumstances of this case, is the taxpayer entitled to have restored to its invested capital for the fiscal years ended September 30, 1918, and September 30, 1920, the sum of \$457,319.02, representing its investment in certain stocks, which had been written off on its books in 1911 by a charge against surplus, and which have never been restored to surplus?

STATUTE AND REGULATIONS INVOLVED

The applicable statute and regulations involved will be found in the Appendix, *infra*, pp. 17-20.

STATEMENT

The facts in this case were found by the Board of Tax Appeals to be substantially as follows (R. 36-39):

Taxpayer is a corporation organized in 1905 under the laws of the State of New Jersey. It is engaged in the business of producing and selling

raw sugar and owns and operates a number of sugar estates in Cuba. The Guantanamo Railroad Company has been operated as an integral part of the taxpayer's business since 1905 (R. 37). When the taxpayer corporation was organized, it acquired certain sugar estates and 5,630 shares of the common stock of the Guantanamo Railroad Company in exchange for 39,990 shares of its own common stock of a par value of \$100 each, or for a total of \$3,999,000 of its own stock. The remaining ten shares, which made up taxpayer's total common stock of \$4,000,000, had been issued to the incorporators, and \$1,000 paid therefor in cash (R. 37, 84).

The Guantanamo Railroad Company stock so acquired was set up on the taxpayer's books at \$75 a share, or \$422,250. Taxpayer subsequently purchased 1,066 additional shares of stock of the Guantanamo Railroad Company at a total cost of \$35,069.02. As of February 20, 1908, taxpayer's books showed the total cost of 6,696 shares of the common stock of the Guantanamo Railroad Company to be \$457,319.02. This stock has never been sold and is still owned by the taxpayer (R. 37, 85).

Until 1907 there was no railroad in Guantanamo Valley other than the line which had been built many years previously and which was being operated by the Guantanamo Railroad Company. It is a standard gauge road, running from Guantanamo east to Jamaica and west to Soledad and is equipped to move freight and to operate pas-

senger trains. It hauls all the cane and the raw products of the taxpayer corporation. The taxpayer has never received any dividends from the Guantanamo Railroad Company but operated the railroad for the benefit of its sugar business after it acquired a controlling interest in the stock in June, 1905 (R. 37).

The minute book of the Guantanamo Railroad Company discloses the net income of the company for the years 1900 to 1905, inclusive, and also shows that dividends were declared for those years, as follows (R. 38):

Year	Net income	Dividend
		<i>Percent</i>
1900.....	\$40,180.68	5½
1901.....	23,880.57	5
1902.....	47,192.94	3
1903.....	11,837.88	None
1904.....	11,104.13	None
1905.....	59,722.24	None

In 1907 a competing railroad was constructed and thereafter the sugar estates which were not owned by the taxpayer began to ship their products over the new line. The taxpayer continued to use the Guantanamo Railroad Company in its own business and advanced considerable sums of money to that company from time to time until by the end of 1918 taxpayer had loaned the Guantanamo Railroad Company approximately \$1,000,000, which amount is still outstanding. The Guantanamo Railroad Company has paid no dividends for any period since the year 1902 (R. 38).

At a meeting held on December 13, 1911, it was resolved by the directors of the taxpayer corporation that the cost of the shares of the Guantanamo Railroad Company should be carried on the books at a nominal value of \$1 and it was further resolved that there should be written off the cost of property the total sum of \$768,287.25, of which amount the sum of \$465,457.81 represented the shares of stock of the Guantanamo Railroad Company owned by the taxpayer (R. 38). In accordance with this resolution the several property accounts were reduced and there was charged to surplus as of December 30, 1911, the total sum of \$768,287.25 (R. 87). This amount was not restored to or included in the taxpayer's invested capital in the years involved herein. In the returns filed by the taxpayer for the taxable years the assets thus written off were not claimed as a part of the taxpayer's invested capital (R. 39).

The Commissioner, upon examination of the returns of the taxpayer for the fiscal years ended, respectively, September 30, 1918, September 30, 1919, and September 30, 1920, as shown by the sixty-day letter to the taxpayer (R. 8-30), found an over-assessment for the fiscal year ended September 30, 1919, and proposed deficiencies for the other two years, 1918 and 1920. From that determination of deficiencies the taxpayer appealed to the Board of Tax Appeals. Its original petition to the Board (R. 4-5) raised other issues, which were abandoned

by the subsequent filing of the amended petition (R. 32-34). By its amended petition, the taxpayer for the first time raised the issue here presented, by asserting the right to restore to its invested capital for the years in question the amount of \$768,287.25, which had been written off pursuant to the resolution of its Board of Directors in 1911, and which included the amount of \$465,457.81 representing on its books the amount of its investment in the stock of the Guantanamo Railroad Company (R. 33).

At the hearing before the Board, the taxpayer stipulated into the record (R. 61) that it would make no claim for the restoration to invested capital of any of the assets written down pursuant to the resolution of the Board of Directors, except the Guantanamo Railroad Company stock. The taxpayer further agreed that it would limit its claim to restoration on this item to the sum of \$457,319.02, instead of the full amount of \$465,457.81 claimed in the amended petition, the slight difference between the figures representing small purchases which the taxpayer was unable to prove. It was agreed by the parties that this discrepancy of approximately \$8,000 would be admitted by the taxpayer and claim made for only the lesser sum, with the understanding that counsel for the Commissioner would raise no objection relative to such inconsistency between the amounts claimed and proved (R. 39).

The Board of Tax Appeals, by its memorandum opinion (R. 36-42), decided against the taxpayer and accordingly upheld the deficiencies as determined by the Commissioner, \$2,147.95 and \$52,568.24 for the fiscal years ended September 30, 1918, and September 30, 1920, respectively. The taxpayer brings the questions thus presented to this Court for review.

SUMMARY OF ARGUMENT

The claim of the taxpayer, that, under the Revenue Act of 1918 and the decisions construing the same, it is entitled to restore to its invested capital the cost, as indicated by its books, of the railroad stock, or the fair market value thereof at the time of its acquisition, even if it were admitted to be correct in theory, is not applicable under the facts of this case. The refusal of the Board to allow the restoration of the railroad stock to invested capital does not infringe upon or take away any part of the right of the taxpayer to include in its invested capital the full amount of its original investment, as the taxpayer contends. The entire argument of the taxpayer is without merit, because the Commissioner, in reaching his determination of the deficiencies in question, actually allowed to be included in the computation of invested capital the full amount of the original investment and an additional amount as earned surplus. Therefore,

the arguments of taxpayer, even if they were admitted to be correct in theory, are not applicable to the facts.

ARGUMENT

The Board in its opinion (R. 36-42), in upholding the deficiencies determined by the respondent and in denying the claim of the taxpayer to restore to its invested capital the item in question, held that the taxpayer was not entitled to the restoration because it had not shown that the railroad stock had retained its value during the taxable years in question. After pointing out that the railroad company after 1907 lost all of its business other than that of the taxpayer, and that its operation progressively became less and less successful, that no dividends had been paid by the railroad company since 1902 and that it had incurred heavy obligations to the taxpayer, the Board concluded that there was nothing before it to indicate that the railroad stock held by the taxpayer was, in the taxable years, worth any more than the nominal value of one dollar, at which said stock was entered on the books in 1911. Accordingly, the Board held that the taxpayer had failed to show that it was entitled to the restoration, and upheld the deficiencies determined by the Commissioner.

In the present appeal, the taxpayer in its brief specifies eleven errors to be urged (Br. 9-11). Of these, all but one deal with the issue of the right to restore to invested capital the sum of \$457,319.02,

representing the alleged cost and actual cash value of the railroad stock in question. The remaining assignment, No. 11, which deals with another matter, will be disposed of first. In No. 11, the taxpayer charges that the Board erred in overruling its motion for review by the whole Board of the memorandum opinion. We submit that there is no merit whatsoever in this assignment of error. The Revenue Act regulating the procedure before the Board provides, in Section 907 (a) of the Revenue Act of 1924, as amended by Section 601 of the Revenue Act of 1928:

If an opportunity to be heard upon the proceeding is given before a division of the Board, neither the taxpayer nor the Commissioner shall be entitled to notice and opportunity to be heard before the Board upon review, except upon a specific order of the Chairman.

The overruling of the motion for review by the whole Board, like a petition for rehearing, rests within the sound discretion of the Board. See *Bankers' Pocahontas Coal Co. v. Burnet*, 287 U. S. 308; *Wise & Cooper Co. v. Commissioner*, 53 F. (2d) 843 (C. C. A. 1st); *Jankowsky v. Commissioner*, 56 F. (2d) 1006 (C. C. A. 10th).

On the question of the right to restore to invested capital the item of \$457,319.02, representing its investment in the railroad stock which was written off in December 1911, the taxpayer in its brief advances a variety of contentions and arguments to

the effect that it is entitled to restore the item to its invested capital, regardless of the fact that such stock may or may not have lost all of its value prior to the taxable years. The first proposition advanced is to the effect that, since, it is asserted, a mere increment in value of assets cannot be taken into account in computing invested capital, likewise a decrease in value cannot be taken into account in computing invested capital, or be made the basis for a writing down of the assets on the books and treating the written down figure as the invested capital. To be entitled to the restoration, the taxpayer claims it is only required to prove that the railroad stock was, at the time of its acquisition, fairly worth the value of the stock of taxpayer issued in the purchase thereof, \$422,250 (at which price the original 5,630 shares acquired with the sugar estates were set up on taxpayer's books), which, together with the amount subsequently paid for the additional shares, brought the total cost to taxpayer to \$457,319.02. This, it is contended, was established by proof before the Board, and the restoration should therefore have been allowed.

We point out in passing that the taxpayer is unable to refer to any express provision of the statute or to any express holding of any court to the effect that it is entitled to the restoration of the cost of assets written down where the assets have lost their value. However, we deem it wholly unnecessary to discuss all of these contentions made

or arguments advanced by taxpayer in its brief, because, even if they were admitted to be correct in theory, they are not applicable to the facts of this case. All of the taxpayer's arguments are, under the facts of this case, entirely beside the point.

The provisions of the statute and Regulations governing this question permit the inclusion in invested capital of cash paid in, the cash value of tangible property paid in for stock, and earned surplus and undivided profits of prior years, in addition to the value of intangible property, subject to certain limitations. Revenue Act of 1918, Section 326 (a) (1) (2) (3); Regulations 45, Articles 831, 838, *infra*. Tangible property is defined to include shares of stock. Section 325 (a), *infra*. The provision which allows the inclusion in invested capital of the cash value of tangible property paid in for stock (Section 326 (a) (2)), expressly limits the amount to be included by the provision that "in no case to exceed the par value of the original stock or shares specifically issued therefor." An exception, not here material, is provided for the case where the value of the property paid in is greater than the par value of the stock issued therefor, in which case the excess is treated as paid-in surplus.

It is clear that all that the taxpayer is entitled to have included in its invested capital is the value of the property (the railroad stock) paid in for its

own stock, but not to exceed the par value of the stock issued therefor, plus whatever earned surplus may *actually have existed* at the beginning of the taxable years in question. In this case, as disclosed by the record, the taxpayer acquired certain sugar estates and the railroad stock in question by the issuance of 39,990 shares of its own capital stock, of the par value of one dollar each, making a total of \$3,999,000 (R. 84). That amount, plus the \$1,000 in cash paid in for the incorporators' shares (R. 84), represents its original investment, and is, under the law, the minimum allowable as invested capital, but in addition thereto, there may also be included such additional earned surplus or undivided profits of prior years as *actually* existed.

It appears from the record that the Commissioner, in his computations for the taxable years in question, allowed to be included in invested capital the total of \$6,004,680.42 for the fiscal year 1918 and \$7,624,199.80 for the fiscal year 1920, so that in both taxable years the amount actually allowed by the Commissioner to be included in invested capital greatly exceeds the amount of the original investment of the taxpayer. The "proof of invested capital" made in connection with the fiscal year 1918 shows that the Commissioner allowed to be included in invested capital the entire capital stock of the company, \$3,000,000, and a surplus in excess of \$2,500,000, in addition to other items (R. 15). The "proof of invested capital" made in connection with the fiscal year 1920 shows that the Commis-

sioner allowed to be included in the computation of invested capital the capital stock of the taxpayer, \$3,000,000, and surplus in excess of \$3,500,000, in addition to other items ² (R. 29).

At the time the original assets, including the railroad stock in question, were acquired by the taxpayer, the record discloses that its capital stock account was credited with the total of \$3,999,000, \$422,250 of which the taxpayer apportioned off as the cost of the railroad stock then acquired, and debited its "Guantanamo Railroad Company Stock Investment Account" with the sum so apportioned off (R. 84, 85). At the time that the assets in question were written down to one dollar pursuant to the resolution of the Board of Directors in 1911, the record discloses that the taxpayer did not debit its capital stock account. Instead, it debited its surplus account with the amount of the assets written off, \$768,287.25 (R. 86), of which \$457,319.02 was applied as a credit to its investment account of the Guantanamo Railroad Company stock.

The railroad stock in question having, as found as a fact by the Board (and such finding is amply supported by the evidence), lost all of its value before the taxable years, the figure at which it had

² The record does not show how the original capital stock issued by the taxpayer to the total par value of \$4,000,000 became or was reduced to a total par value of \$3,000,000 in the two taxable years in question, as shown by the "proof of invested capital." However, the amount allowed as invested capital by the Commissioner is in both years greatly in excess of the original investment, so that the difference is not material.

been carried on the books prior to the writing down did not in reality in the taxable years in question constitute earned surplus or undivided profits accumulated in prior years. Accordingly, therefore, the taxpayer was not entitled to have that figure added in the computation of its invested capital, and the Board therefore properly refused to allow the restoration sought by the taxpayer.³

From the foregoing it is clear that the taxpayer is not entitled to the restoration it seeks, because the Commissioner has already allowed to be included in invested capital all of the capital stock of the taxpayer, including that which was issued for the railroad stock in question, plus a substantial amount as earned surplus, and the total amount allowed as invested capital is in both taxable years greatly in excess of the original investment. As has been shown, the amount of the original investment is the minimum which the taxpayer was entitled to have included in the invested capital. In addition thereto the taxpayer was entitled to have also included therein such earned surplus as *actually existed* at the beginning of the years in

³ The decision of the Board is correct. The fact that the Board may have inaccurately stated the theory of law upon which its decision was based, or perhaps even acted on the wrong theory of law, is immaterial, and its decision should nevertheless be affirmed if the facts as found by it (supported by the evidence), when governed by the correct rule or theory of law, are sufficient to sustain the decision. *Helvering v. Rankin*, 295 U. S. 123; *Lewis-Hall Iron Works v. Blair*, 23 F. (2d) 972, 974, 975 (App. D. C.); *Hurwitz v. Commissioner*, 45 F. (2d) 780, 781 (C. C. A. 2d).

question. This is unquestionably the way in which the courts have interpreted the statute. In the case of *La Belle Iron Works v. United States*, 256 U. S. 377, the Supreme Court said (pp. 389-390) :

It is clear enough that Congress adopted the basis of "invested capital" measured according to actual contributions made for stock or shares and *actual* accessions in the way of surplus, * * *. [Italics ours.]

See also *Ralston Steel Car Co. v. Commissioner*, 53 F. (2d) 948 (C. C. A. 6th), and *Guarantee Construction Co. v. Commissioner*, 2 B. T. A. 1145, 1151.

The taxpayer is not entitled to have, as it seeks, included in its invested capital *both* the amount of its capital stock issued for the assets originally paid in and the value of the assets so paid in, where the full par value of the stock originally issued for the property paid in has been allowed to be included, and where the assets originally paid in have lost their value. The entire amount of the original investment (and considerably more) has been allowed to be included in invested capital. Therefore, taxpayer is not entitled to have included therein the cost or original value of the railroad stock, because, such stock having become worthless, it does not represent *actual* earned surplus or profits accumulated in prior years. It would only be in the case where the total amount allowed by the Commissioner as invested capital is less than the total original investment that the taxpayer would have the right to have included in its invested capital the

original cost or value of assets originally paid in, although such assets have lost all of their value, and that, of course, only up to the extent that would equal the amount of the original investment. But as long as there has been allowed to be included in the computation of invested capital an amount equal to or greater, as in this case, than the original investment, the taxpayer is not entitled to include therein the cost or former value of the assets originally paid in. In this case, as indisputably shown by the record, the Commissioner has allowed to be included in the computation of invested capital for both of the taxable years here in issue a total amount by far greater than the amount of the original investment. The taxpayer, therefore, has no right to have these original assets, which have lost their value, added to its invested capital, and the Board therefore properly refused to allow the restoration sought by the taxpayer.

CONCLUSION

It is submitted that the decision of the Board of Tax Appeals is correct, is in accordance with the law, and should therefore be affirmed.

Respectfully submitted.

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MARCH 1936.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057:

PART V.—INVESTED CAPITAL

SEC. 325. (a) That as used in this title—

* * * * *

The terms “tangible property” means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property; * * *.

SEC. 326. (a) That as used in this title the term “invested capital” for any year means (except as provided in subdivisions (b) and (c) of this section):

(1) Actual cash bona fide paid in for stock or shares;

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: * * *;

(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

* * * * *

Treasury Regulations 45, promulgated under the Revenue Act of 1918:

ART. 831. *Meaning of invested capital.*—Invested capital within the meaning of the statute is the capital actually paid in to the corporation by the stockholders, including the surplus and undivided profits, and is not based upon the present net worth of the assets, as shown by an appraisal or in any other manner. The basis or starting point in the computation of invested capital is found in the amount of cash and other property paid in, the valuation at which such other property may be included being determined in accordance with the statute and the regulations. The computation does not stop, however, with such original entries or amounts, but also takes into account the surplus and undivided profits of prior years left in the business. * * *

* * * * *

ART. 838. *Surplus and undivided profits: earned surplus.*—Only true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence, or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any

discount on its bonds. There can, of course, be no earned surplus or undivided profits until any deficit or impairment of paid-in capital due to depletion, depreciation, expense, losses, or any other cause has been made good. * * *

* * * * *

ART. 840. *Surplus and undivided profits: additions to surplus account.*—A corporation's books of account will be presumed to show the facts. If it claims that its capital or surplus account is understated the burden of proof will rest upon it. * * *

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ART. 841. *Surplus and undivided profits: limitation of additions to surplus account.*—Additions to surplus which a corporation may desire to make under the preceding article fall broadly into two classes:

(1) To correct returns of net income for prior years in which actual errors have been made, as for example where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

(2) To reinstate in surplus deductions from income which are as a matter of good accounting to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc.

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In any case in which there is an operating deficit amounts restored must first be set off against the deficit and only the excess can be actually included in the computation of invested capital.

ART. 842. *Surplus and undivided profits: property paid in and subsequently written off.*—Where tangible or intangible property has been paid in to a corporation for stock or shares or as paid-in surplus, and has subsequently been in whole or in part written off the books, the amount so written off may upon evidence satisfactory to the Commissioner be restored to the capital or surplus account subject to the following limitations:

(1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence, or depletion; and

(2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.

IN THE
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—
No. 6458.
—

GUANTANAMO SUGAR COMPANY, *Petitioner*,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, *Respondent*.

—
REPLY BRIEF FOR PETITIONER.
—

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In his brief respondent does not attempt to defend the reasoning by which the Board of Tax Appeals reached the conclusion that petitioner was not entitled to have included in its invested capital the cost and value at the time of acquisition of the shares of stock of Guantanamo Railroad Company which petitioner on December 31, 1911, had written down in the books to the nominal sum of \$1.00. It is the holding of the Board that because petitioner did not prove that this stock continued to have its invested capital value in the taxable years in question the same might not be restored to invested capital.

In this Court respondent has taken another tack, and now contends that because petitioner has been al-

lowed the full amount of the par value of its outstanding stock during the taxable years, and in addition a substantial amount of surplus, in default of a showing that the Guantanamo Railroad Company stock had a substantial value in those years it may not be restored to invested capital.

Respondent's reasoning seems to run somewhat as follows: The minimum invested capital to which petitioner is entitled is the amount of cash and the actual cash value of tangible property paid in for stock—in the case at bar, since there were no intangibles paid in for stock, the full amount of its original capital. If any earned surplus or undivided profits are to be included in invested capital, the burden is on petitioner to show that it had an actual surplus at the beginning of the taxable years. If this stock is not worth more than the \$1.00 at which it was carried on the books, then petitioner did not have an actual surplus greater than its book surplus. Hence it is not entitled to restore the amount of the write-off to invested capital.

There is neither reason nor authority in the regulations or the cases for this principle. The cases cited by respondent in support of this proposition are, if at all relevant, authorities against it. It is true that Article 838 of Regulation 45 states that "only true earned surplus and undivided profits can be included in the computation of invested capital." It then proceeds to explain what is meant by this phrase, namely, that full recognition must be given to all expenses incurred and losses sustained from the organization of the corporation until the taxable year and that there can be no earned surplus or undivided profits until any operating deficit or impairment of capital has been made good. This is unquestionably sound and is sup-

ported by conclusive authority. (*Willcutts v. Milton Dairy Co.*, 275 U. S. 215.)

In other words if a corporation has sustained an operating deficit or losses in the income tax sense of the word, namely, realized losses, which are deductible from its income, it will not be heard to say that it has an earned surplus which can be taken into invested capital and added to its paid in capital until such operating deficit or impairment of capital arising in the manner set forth above has been made good. When, however, the regulations come to deal with the restoration to invested capital of mere book write-offs, not a word is said about making good an impairment of capital, Article 842 of Regulation 45 imposes only two conditions to permitting such restoration: (1) that proper allowance shall be made for depreciation, etc., in the case of a depreciable asset; (2) the aggregate amount to be included in invested capital shall not exceed the amount which might have been included had the write-off not been made.

The draughtsmen of Regulations 45 had a keener insight into the purpose of the excess profits tax provisions of the Revenue Act of 1918 than has respondent—doubtless for the reason that they were closer to the framers of the Act and knew what was intended by Congress. No distinction is made in Article 842 between restoration to capital and restoration to surplus. Apparently it depends upon whether the write-down has been charged to capital or to surplus. In the case at bar the charge was to surplus and the restoration should presumably be to surplus. No requirement is made that the taxpayer must show the existence of an actual surplus.

Just as an asset written up can go into invested capi-

tal at its cost only and not at its appreciated value, so an asset written down must go in at its cost and not at its written down value. The tax is to be measured by the amount of the actual investment and not by write-ups and write-downs, however proper the same may be from an accounting standpoint. This is fair to the Government and fair to the taxpayer. The latter pays a tax measured by the ratio of its net income to the amount which actually went into the business, no matter how certain assets may have been treated on its books. This is what the Supreme Court held in the case of *La Belle Iron Works v. U. S.*, 256 U. S. 377, which is the converse of the case at bar. This is the view consistently adopted by the Regulations governing the excess profits tax law. This, it is understood, has been the consistent practice of the Bureau of Internal Revenue in administering the tax. It would be quite inconsistent with authority and with practice to adopt the novel principle contended for by respondent, and to attempt to assimilate arbitrary write-offs to actual impairment of capital and to require a taxpayer, who for one reason or another has written off an asset, (not by way of depreciation, depletion, obsolescence, etc.) to prove that the asset, which cost him a substantial sum, still has that value before the amount written off may be restored to invested capital.

Respectfully submitted,

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